The Infinite Banking Concept™

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Infinite Banking Concepts On-Line Store Shipping Notice - *We will not be shipping IBC products from 6-9 January. We will still accept on-line orders and will resume shipping on Monday, 11 January.*

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)

Thursday-Friday, January 15-16, Austin, TX, Paul McDonald 512-345-2734, paul@econwbs.com or Ben Waggoner 512-965-0391, ben@econwbs.com

Friday-Saturday, January 23-24, Indianapolis, IN, Richard Broadbent, 317-581-3995, richard_broadbent@glic.com

Tuesday-Wednesday, January 27-28, Nacogdoches, TX, Ricky Heard, 936-564-1735, rickyh@cbhins.com

Thursday-Friday, January 29-30, Austin, TX, Teresa Kuhn, 512-301-7702, tkuhn@safeharborins.com, or Rodney Stockton, 512-694-0042, rkstockton@hotmail.com

Thursday-Friday, February 5-6, Little Rock, AR, Becky Rice, 501-221-7400, becky@rebeccarice.net

Monday-Tuesday, 9-10 February, Birmingham, AL, David Stearns, 205-276-2977, david.stearns@charter.net

Wednesday-Thursday, 11-12 February, Birmingham, AL, Winter Infinite Banking Concepts Think Tank Symposium, David Stearns, 205-276-2977, david.stearns@charter.net

Friday-Saturday, 20-21 February, Seattle, WA, Rich Keal, 888-888-6208, rich@genwealth.net

Thursday-Friday, 26-27 February, Dallas, TX, Joe Kane, 512-345-2734, jkane@pegplanning.com

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

BASIC ECONOMICS, SECOND EDITION 1988 - Clarence B. Carson, Boundary Stone Publishers

BASIC AMERICAN GOVERNMENT - Clarence B. Carson, American Textbook Committee, Boundary Stone Publishers

Nelson's Favorite Quotes of the Month

The great missionary, like the great artist, is able to convince some people of the truth of ideas they already half hold, but have been impeded by propaganda or restraints from adopting. Thus he liberates them to become what they have partly wanted to be all along, and so they move in the new direction not only without regrets but with joy.
- John U. Nef

Joshua 14:7-11 I was forty years old when Moses the servant of the Lord sent me from Kadesh Barnea to explore the land. And I brought him back a report according to my convictions, but my brothers who went up with me made the hearts of the people melt with fear. I, however, followed the Lord my God wholeheartedly. So on that day Moses swore to me, 'The land on which your feet have walked will be your inheritance and that of your children forever, *because you have followed the Lord my God wholeheartedly. Now then, just as the Lord promised, he has kept me alive for forty-five years since the time he said this to Moses, while Israel moved about in the desert. So here I am today, eighty-five years old! I am still as strong today as the day Moses sent me out;* ***I am just as vigorous to go out to battle now as I was then.*** *[Emphasis added]*

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

Hamilton's Counterfeit Capitalism

Daily Article by George F. Smith | Posted on 12/16/2008

As we await Bush's replacement to straighten our wayward lives, it's crucial to understand how we got here and why policy makers are so determined to do the wrong thing. Austrian economics explains why their policies are flawed, but no one with a voice seems to care. When history confirms that hands-off is the only effective and humane approach to a bust, and to prosperity generally, while hands-on brings ruination, why do governments today consider every option but free markets?

You could blame it on the heavy influence of Keynesianism, but we could ask why Keynes is so popular. He got away with blaming the market for the Depression of the 1930s. How can his followers do the same today after 70 more years of intense interventionism? To read today's mainstream commentaries, you would think the free market slipped in the back door when no one was looking.

We know governments have always meddled in their economies, but the United States was supposed to be appreciably different. Did we begin with unhampered markets, witness their failure, then switch to a more "progressive" approach? At what point in our history did we begin promoting interventionism as an ideal?

Review the country's founding, and it isn't immediately obvious where the state's heavy hand first made its mark. Nowhere in the Declaration, for example, do we find a footnote calling for high taxes and a central bank to support our inalienable rights. It's hard to imagine that the patriots who fought at Breed's Hill or Yorktown were inspired by visions of a massive redistribution of their wealth to special interests. But when we consider the Constitution's "general welfare" clause, we start to wonder. Was it colonial shorthand for *anything goes, provided sufficient political support*?

Thomas Jefferson said no; Congress did not have unlimited powers to provide for the general welfare, "but were restrained to those specifically enumerated." His political rival Alexander Hamilton, on the other hand, had two answers. As the author of Federalist #84, in which he referred to constitutions "as limitations of the power of government itself," he might agree with Jefferson, at least publicly. But later, as Treasury secretary under Washington, he dropped the façade of government restraint. As long as any proposed legislation was "in the public good," he considered it lawful under the Constitution.

As Thomas J. DiLorenzo tells us in his engaging new book, *Hamilton's Curse: How Jefferson's Arch Enemy Betrayed the American Revolution — and What It Means for Americans Today*,

Hamilton dismissed Jefferson's strict constructionism and viewed the Constitution as a grant of powers rather than as a set of limitations. With clever manipulation of words, he believed, the Constitution could be used to approve virtually all government actions without involving the citizens at all.

In a recent article, DiLorenzo says that Hamilton "fought fiercely for his program of corporate welfare, protectionist tariffs, public debt, pervasive taxation, and a central bank run by politicians and their appointees out of the nation's capital."

Regarding the stipulation that policies must promote "the public good" or serve "the public interest" — phrases that Hamilton used countless times — DiLorenzo reminds us that "no government policy can be said to be in 'the public interest' unless it benefits every member of the public." And how often does that happen? The "public interest" turns out to mean favored special interests.

A Revolutionary War hero and aid to General Washington, Hamilton began pushing for "a government of more power" in 1780; and in 1787, with the help of a gross distortion of Shays's Rebellion, he brought state delegates together for the Constitutional Convention, the proceedings of which were closed to the public. According to an 1823 book by John Taylor of Caroline, which relied heavily on notes taken by Convention delegate Robert Yates, Hamilton moved quickly to consolidate all power in the hands of the executive branch, proposing a permanent president and senate.

Governors of the states would be appointed by the national government, and any state law that conflicted with the federal constitution would be considered void. What Hamilton wanted was a "great" national government much like the one from which Americans had recently seceded. Not surprisingly, the convention attendees rejected his proposal, establishing instead a confederation of free and independent states that delegated a few specific powers to the central government.

In 1802, Hamilton privately denounced the Constitution as "a frail and worthless fabric," but by then he had already established the methodology for rendering it irrelevant, as DiLorenzo puts it, through the "lawyerly manipulation of its words."

Hamilton's Agenda

In his 1791 *Report on Manufactures*, he urged Congress to authorize the payment of "pecuniary bounties" (subsidies) to the manufacturers of certain items, on the basis of the general-welfare clause. The clause was "doubtless" intended to mean more than what it expressed, Hamilton argued, so it was up to Congress to decide what it meant and how to fund it. As DiLorenzo points out, generations of nationalist judges have used Hamilton's argument to expand the government far beyond its constitutional limits.

In addition, the nation, not the states, had "full power of sovereignty," Hamilton insisted. The states were "artificial beings" and thus it would make no sense to talk of their right of secession — though somehow those same artificial states had united to secede from England. Furthermore, Hamilton argued, the Constitution grants the government "implied powers," one of which was to establish a national bank to promote a "paper circulation" and thereby extend loans in excess of its reserves of gold and silver. Hamilton said the Constitution's commerce clause gave government the power to regulate all commerce, not just interstate commerce. A national bank, which would regulate commerce within states, was thereby authorized.

As DiLorenzo explains, Hamilton and his nationalist compatriots couldn't make mercantilism work with a confederation of sovereign states. If northern states passed a high protectionist tariff, for example, imports would flood into the low-tariff southern states, then spread to the rest of the country. With a nationalist government, high tariffs could be imposed on all states, with some states effectively being taxed for the benefit of other states.

A Standing Army of Tax Collectors

Hamilton interpreted the Constitution's "war powers" to mean "that *unlimited* resources should be given to the military, including conscription and a standing army in peacetime," DiLorenzo writes. "He also wanted government to nationalize all industries related to the military, which in today's world would mean virtually all industries."

A standing army in times of peace was necessary to enforce government taxation. And what better way to make this point than to do a little enforcing? Thus, in 1794, Hamilton personally accompanied President Washington to western Pennsylvania with 13,000 conscripts and officers from the creditor aristocracy of the eastern seaboard to crush the so-called Whiskey Rebellion. After rounding up a score of tax rebels, some of whom were old and veterans of the Revolutionary War, Hamilton drove them through the snow in chains all the way to Philadelphia, where he ordered local judges to issue guilty verdicts and sentence them to be hanged. Washington, who had returned home before the cross-state slog, pardoned the only two who were eventually convicted, leaving Hamilton bitterly disappointed.

Other areas of the American frontier — in Maryland, Virginia, North and South Carolina, Georgia, and the entire state of Kentucky — engaged in home whiskey production and fiercely opposed the new tax. Whiskey was not only a beloved consumable, it served as money, as a medium of exchange, and locals considered the tax as onerous as the king's Stamp Tax of 1765. There was no rebellion in these areas because no one was willing to collect the taxes. Hamilton had picked the four counties in western Pennsylvania as his target because local officials were corrupt enough to help him.

The tax and the federal assault on the protestors put the spotlight on Hamilton's "public interest" tactic. As Rothbard noted, "in keeping with Hamilton's program, the tax bore more heavily on the smaller distilleries. As a result, many large distilleries supported the tax as a means of crippling their smaller and more numerous competitors." The smaller distilleries were taxed by the gallon, while the larger ones paid a flat fee.

The hated tax also helped get Jefferson elected in 1800. The election resulted in a tie between Jefferson and Aaron Burr, and was thus thrown into the House. Selecting who he considered the lesser of two evils, Hamilton used his influence to break the tie in favor of Jefferson, a deed that helped bring about his fatal duel with Burr in 1804.

But before Jefferson took office, DiLorenzo explains, Federalist President John Adams helped Hamilton's cause when he appointed hundreds of "midnight judges" to the federal judiciary in the last 19 days of his administration. Though Jefferson got rid of most of them, he overlooked the appointment of Hamilton idolater John Marshall, who served as chief justice from 1801–1835.

"In *Marbury v. Madison* [1803] John Marshall essentially asserted that *he*, as chief justice, had power over *all* congressional legislation," DiLorenzo writes. This was consistent with Federalist #78, where Hamilton said it belongs to the courts "to ascertain [the Constitution's] meaning as well as the meaning of any particular act proceeding from the legislative body." Though *Marbury v. Madison* marks the birth of judicial review, the Hamiltonian idea that the government should be the sole judge of its own actions didn't prevail until it was imposed by force of arms — during the War between the States.

Hamilton's Disciples

Following Hamilton's death, Kentucky senator Henry Clay, a wealthy slaveholder known as the "prince of hemp" for his huge hemp crops, joined Marshall and others in promoting statism and corporate privilege. As DiLorenzo tells us, Clay "spent decades, literally, advocating protectionist tariffs on foreign hemp; government-subsidized roads and canals, so that he could transport his hemp eastward; a nationalized bank that could inflate the economy." Clay wanted to force complete self-sufficiency on the country and deprive Americans of the benefits of the international division of labor — a good deal for Kentucky hemp growers, but not for consumers.

Far from bringing about the harmonious relations Clay promised, his mercantilist agenda provoked sectional strife. The tariffs he championed "overwhelmingly favored northern states," inasmuch as there was little manufacturing in the South even by the 1860s. "To southerners, tariffs were all cost and no benefit." Protectionist tariffs, an essential part of Hamilton's scheme for a mercantilist America, would be a prime mover of the forces for war.

When Lincoln became president, he moved quickly to implement Hamilton's system of corporate welfare. Not even his bloody war deterred him. He and his majority Republicans imposed tariff rates of 50 percent, authorized enormous subsidies to railroad corporations, and created a nationalized banking system. Greenbacks issued under the new system depreciated by more than half, and consumer prices in the North more than doubled between 1860 and 1865. Because of the inflation, real wages plummeted, and the war ended up costing northern taxpayers $528 million more, DiLorenzo says.

The Credit Mobilier scandal of 1882 was the most notorious consequence of Hamiltonian corporate welfare, but, as DiLorenzo notes, "it was only the tip of the iceberg" of the predictable waste and corruption that results from government favors. The public was outraged over the scandal and called for more political control of business — they called, in other words, for more of what created the problem in the first place.

As Gabriel Kolko showed in his 1963 ground-breaking work, *The Triumph of Conservatism*, "American businesses, far from resisting political control, *sought* such regulation because they could use it to their advantage," DiLorenzo explains. The railroad industry, for example, lobbied for creation of the Interstate Commerce Commission, which soon outlawed discounts to customers. Cornelius Vanderbilt had been engaging in this "ruthless" practice, but "[b]y making discounts illegal, the ICC relieved railroad companies from the pressure to compete for customers." Other businesses such as gas and electric utilities turned to the political arena for grants of monopoly — seeking to obtain from government what they failed to achieve on the market.

The Hamiltonian Revolution of 1913

In 1913, government acquired effective control of the country's wealth and strengthened its rule over the states by passing three laws: the income tax, the direct election of senators, and the federal reserve act. The first two arrived as the Sixteenth and Seventeenth Amendments; the "currency bill" was slipped in just before Christmas. All three, per Hamilton's rhetoric, were promoted under cover of "the public interest." All three were cons — abuses of confidence by public officials. All three "delivered a death blow to the old Jeffersonian tradition in American politics," and brought about "the final, decisive victory for the Hamiltonians."

Were these laws really so bad? Judge for yourself.

Prior to the Seventeenth Amendment, US senators were "ambassadors of the states"; they were appointed by state legislatures. They would speak for their state governments, which would presumably have control over how they voted. Having senators appointed was intended as a check on the powers of the federal government. It limited "senators' ability to sell their votes to special-interest groups nationwide," DiLorenzo explains. Thanks to the Seventeenth Amendment, political corruption has "expanded by orders of magnitude," he says. "U.S. senators now travel all around the country seeking special-interest campaign contributions."

An income tax was not popular in Hamilton's day, but he recognized the need for high taxes to fund the "energetic" government he wanted. The first federal income tax was imposed in 1862, and though it was abolished a decade later, "the experience had whetted the appetites of special-interest groups," DiLorenzo writes. By 1913, American farmers had made a deal wherein they would support an income tax in exchange for lower tariff rates. The income tax became law in 1916, and by 1930 tariff rates had soared to their highest level ever — 59.1 percent, on average. So much for the farmers' deal making.

After the adoption of withholding in 1943, the income tax became entrenched, as Charlotte Twight has written, "both through its administrative apparatus and through its acceptance in the minds of most taxpayers." With its confiscation of enormous amounts of wealth and the army of bureaucrats and agents needed for collection, the income tax renders states as well as citizens hat-in-hand beggars when trying to influence the federal government. In their relationship to Washington, states have become Hamilton's "artificial beings."

Loathing and fearful of competition, big businesses in the late 19th century tried to form voluntary cartels, but such arrangements are notoriously unstable, DiLorenzo points out, so they turned to government to make them work. What the big bankers wanted was a monopoly of the issue of bank notes so they could have a more "elastic currency." Previously, if an individual bank issued too many notes, depositors would get nervous and demand redemption in gold. Because all banks issued more notes or deposits than they had gold in reserve, they were all one bank run away from being exposed.

The currency act that created the Fed in 1913 was a crucial step in eliminating this problem — for the bankers. Two decades later, the government took gold out of the picture, so that covering a member shortfall was no longer a problem. Through the magic of the printing press, the Fed could also provide instant revenue to the government to pay for military adventures.

The Fed and the income tax provided the "funding mechanisms" for getting the United States into the European slaughterhouse called World War I. "Like all wars, World War I permanently ratcheted up the powers of government and fueled the urge among politicians to 'plan' American society in peacetime just as they had planned in war," DiLorenzo explains.

The Fed has the power to do the one thing it shouldn't do: regulate the money supply. By doing so it distorts price relations and guarantees a correction, which, since 1929, the government regards as a clarion call to "do something." Ignoring economic wisdom, it does everything it can to prevent the necessary correction, thereby making the recovery longer and more painful. When the economy pulls out of the depression, government takes the credit, and the Fed begins inflating again, inaugurating another boom-bust-correction/intervention-crisis sequence that will bear heavily on almost everything we hold dear. Between 1789 and 1913, prices remained roughly stable, DiLorenzo notes, and government was little more than a footnote in people's lives. Since 1913, prices have increased twentyfold, while today government intrusion has no limits.

Conclusion

As with his two books on Lincoln, Thomas J. DiLorenzo has done a masterful job of exposing an American icon whose influence has been highly detrimental to the majority who live outside the rarefied reality of national politics.

Is there any escape from Hamilton's world? It all depends on us. The book's last chapter, "Ending the Curse," calls for a "*devolution of power.*" We need to shake up the ruling caste and strip the central government of its Hamiltonian features, which means, among other things, ending judicial tyranny, repealing the Sixteenth and Seventeenth amendments, outlawing protectionist tariffs, and abolishing the general-welfare clause. We should recall that the latter two measures were achieved in the Confederate Constitution of 1861 as well as state constitutions in the antebellum period. DiLorenzo also wants to dismantle "government's Hamiltonian monopoly on money," which would in itself be a major setback to despotic government.

Hamilton's Curse is a pleasure to read and a must-read for anyone who values freedom and seeks a deeper understanding of the prevailing nonsense.

[Tom DiLorenzo will be the featured speaker at our next ***Infinite Banking Concepts Think Tank Symposium*** on 11-12 February, 2009. The Symposium theme is ***The Current Economic Environment – What better time to take control your financial situation?*** Please join us for what is shaping up to be an exciting meeting.]

The End of the US Piano Industry

by Jeffrey A. Tucker

Today the highest-price good that people buy besides their houses is their car, and this reality leads people to believe that we can't possibly let the American car industry die. We couldn't possibly be a real country and a powerful nation without our beloved auto industry, which is so essential to our national well-being.

What about the time before the car? Between 1870 and 1930, the biggest ticket item on every household budget besides the house itself was its piano. Everyone had to have one. Those who didn't have one aspired to have one. It was a prize, an essential part of life, and they sold by the millions and millions.

Americans before 1850 mostly imported their pianos.

American manufacturing was nearly nonexistent. After 1850, that changed dramatically. The Gilded Age saw a vast increase in popularity. By 1890, Americans fed half the world market for pianos. Between 1890 and 1928, sales ranged from 172,000 to 364,000 thousand per year. It was a case of relentless and astounding growth.

They were used in classrooms everywhere in times when music education was considered to be the foundation of a good education. They were the concert instruments in homes before recorded music and iPods. They were essential for all entertainment. American buyers couldn't get enough, and private enterprise responded.

There was the great Chickering piano made by a company founded in 1823 and which later led the world in beauty and sound. There was Hallet and Davis in Boston, J. and C. Fischer in New York, as well as Strich and Ziedler, Hazelton, William Knabe, Weber, Mason and Hamlin, Decker and Sons, Wurlitzer, Steck, Kimball in Chicago, and, finally Steinway.

The American piano industry was the greatest in the world, not because the Americans came up with any new and great manufacturing techniques, though there were some innovations, but because the economic conditions made it most favorable to be manufactured here.

It was widely believed that spending money on a piano wasn't really spending. It was an investment. The money you paid would be embedded right there in this beautiful and useful item. You can always sell it for more than you paid for it, and this was generally true. So people would make great sacrifices for these instruments.

With the growth of this manufacturing came an explosion of shops that served the piano market all up and down the industry. Piano tuning was a big-time profession. Retail shops with pianos opened everywhere, and the sheet-music business exploded with them. Ever notice how in big cities the music stores are typically family owned and established 40, 50, and even 100 years ago? This is a surviving remnant of our industrial past.

All of this changed in 1930, which was the last great year of the American piano. Sales fell and continued to fall when times were tough. The companies that were beloved by all Americans fell on hard times and began to go belly up one by one. After World War II the trend continued, as ever more pianos began to be made overseas.

In 1960, we began to see the first major international challenge to what was left of the US market position. Japan was already manufacturing half as many pianos as the US. By 1970, a revolution occurred as Japan's production outstripped the US, and it has been straight down ever sense. By 1980, Japan made twice as many as the US. Then production shifted to Korea. Today China is the center of world piano production. You probably see them in your local hotel bar.

And what happened to the once-beloved and irreplaceable American piano industry? Only Steinway survives to make luxury instruments few can afford. The rest moved overseas under new ownership or were completely wiped out.

Does any one care that much? Not too many. Have we been devastated as a nation and a people because of it? Not at all. It was just a matter of the economic facts. The demand went down and production costs for the pianos that were wanted were much cheaper elsewhere.

Now, a piano aficionado reading this will say: buddy, you are crass. Listen to the sound of an older model Chickering and you can tell the difference. It was warm and wonderful, nearly symphonic. It is mellow and perfect for the best repertoire. By comparison, this new Chinese piano is sharp and angular and pointed. It sounds like a marimba. You can't play Schubert or Brahms on such junk. No one wants to hear that thing. Bring back the old days when pianos made sounds that sounded like real music!

Well, you can still get that old Chickering sound, even from a piano made in New York. You can buy a Steinway. Of course you have to pay $50,000 plus and even as much as $120,000, but they are there.

You say that is unaffordable? Says you. It is all a matter of priorities. You can forego your house and live in a tiny apartment and still own the most gorgeous instrument money can buy. In any case, it makes no economic sense for you to demand a magnificent piano at a very low price when reality does not make that possible.

In the same way, many people will bemoan the loss of the US car industry and wax eloquent on the glory days of the 1957 Chevy or what have you. But we need to deal with the reality that this is in the past. Economics demands forward motion, a conforming to the facts on the ground and a relentless and realistic assessment of the relationship between cost and price, supply and demand. We must learn to love these forces in society because they are the only things that keep rationality alive in the way we use resources. Without them, there would be nothing but waste and chaos, and eventual starvation and death. We simply cannot live outside economic reality.

Let's say that FDR had initiated a bailout of the piano industry and the even taken it over and nationalized it. The same firms would have made the same pianos for decades and decades. But that wouldn't have stopped the Japanese industry from taking off in the 60s and 70s. Americans would have far preferred them because they would be cheaper. American pianos, because they would be state-owned, would fall in quality, lower and lower to the point that they would become like a Soviet car in the 1960s. Of course you could set up tariff barriers. That would have forced American pianos on us. Except for one thing: demand would have still collapsed. The pianos still have to have a market. But let's say you find a workaround for that problem by requiring everyone to own a piano. You still can't make people play them and value them.

In the end you have to ask: is it really worth trillions in subsidies, vast tariffs, impositions all around, just to keep what you declare to be an essential industry alive? Well, eventually, as we have learned in the case of pianos, this is not essential. Things come and things go. Such is the world. Such is the course of events. Such is the forward motion of history in a world of relentless progress generated by the free market. Thank goodness that FDR didn't bother saving the US piano industry! As a result, Americans can get a huge range of instruments from all countries in the world at any price they are willing to pay.

Today government is even more arrogant and absurd, and it actually believes that by passing legislation it can save the US car industry. It can subsidize and pay for uneconomic activities, and pay ever more every year. The government can also pay millions of people to make mud pies because mud pies are deemed to be an essential industry. You can do this, but at what cost and what could possibly be the point? Eventually, even the government will have to accord itself to the reality that economics reminds us of on a daily basis.

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Jeffrey Tucker [send him mail] is editorial vice president of www.Mises.org.

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Oldsmobile Nation

by Gary North

On April 29, 2004, the last Oldsmobile rolled off the assembly line in Lansing, Michigan.

The Olds Cutlass had been the #1 selling car in America in the mid-1970's. In the 80's, Olds did well. But in the 90's, it became a stodgy, nothing-special vehicle, stuck in between Pontiac (youth) and Buick (successful middle age). I knew it was not long for this world when an ad agency introduced this slogan: "This is not you father's Oldsmobile!" This immediately popped into my head: "Is it my grandfather's?"

Do you miss the Oldsmobile? Have you given it much thought?

Fast forward to today. Imagine a TV film clip of President-elect Obama. "Oldsmobile is the backbone of American manufacture."

You would think he has gone nuts. Who cares about Oldsmobile? It's gone. Forgotten. Unlamented.

Obama said this on Sunday's "Meet the Press": "The auto industry is the backbone of American manufacture."

That sounded plausible, until we recognize the context: a proposal to bail out GM, Ford, and Chrysler. Not under discussion is a bailout of Toyota, Honda, Nissan, BMW, and other automobile companies that produce cars in the United States.

This is a proposed bailout of the equivalent of Oldsmobile. It is a bailout of firms that could not meet the test of the competitive marketplace. Ford is the best of the bunch, and its share price says, "Oldsmobile!" It was over $35 in 1999, $6 in 2003, $17 in early 2004, and then down, down, down. It is under $3 today. This is Detroit iron's "giant." This is its showcase.

The Big 3 automakers are not the backbone of the American manufacture. Rather, they are located just below the backbone.

Obama continued: "It is a huge employer across many states. I don't think it's an option to allow it simply to collapse."

Not an option? Really? So, is this a one-time infusion of money? They won't be back for more in 2009? 2010? 2011?

Not only is it an option, it is an inevitability. This is your father's Big 3. You will pay to keep them on the road. You will pay indefinitely.

With GM going through money at $2 billion a month, with Chrysler near bankruptcy, and with Ford promising profits no sooner than 2011, they will be back for billions more before the swallows return to Capistrano.

Obama and Congress are also saying that Detroit must make big adjustments. Its plans have not worked. We already know this. That is why their share prices have collapsed, along with their credit ratings. That is why they are lined up in front of Congress, dutifully taking wisecracks from Masters of the Junket about why they were wrong in not flying on commercial jets to come and grovel.

Here is a Congress that is running a trillion dollar official on-budget deficit this year, and that has run up $70 trillion in unfunded Medicare and Social Security obligations, lecturing three CEO's of busted car companies about their failure to plan.

We can see what is coming. Congress will pass new laws governing the recipients. These laws will be the strings attached. There are always strings attached to Federal money. The three CEO's will swallow the cyanide pills because they are groveling for loot extracted from the public. They will consent to anything; just give them the money.

The debate is over whether this is a new bailout or part of the one passed in September, the $25 billion bailout that received little attention. That bailout was to help the Big 3 fund lower polluting cars. Now Congress is considering the siphoning of $15 billion of this money to keep the companies alive long enough to adopt the new technologies.

What about the next round of Big 3 bailouts? Congress will fork over the money. Not to do so would make this bailout look foolish. They will pour good money after bad. Detroit iron is a bottomless pit.

Congress can posture all it wants about the needed restructuring. What does Congress know about building cars that people want to buy? Nothing.

NO MORE PORK!

Obama has assured us that the age of pork is over.

In an interview on NBC's "Meet the Press," Obama said: "What we need to do is examine: What are the projects where we're going to get the most bang for the buck? How are we going to make sure taxpayers are protected?

"You know, the days of just pork coming out of Congress as a strategy, those days are over."

Good news, indeed! The tradition of Congressional pork is going to end, after only 220 years. It's about time!

On this terrific news, stock markets around the world soared.

But there was this news, too.

"If you look at the unemployment numbers ... the fragility of the financial system and the fact that it's an international system," the recession "is a big problem, and it's going to get worse," Obama told NBC News' Tom Brokaw on Saturday. The interview aired Sunday on NBC's "Meet the Press."

Acknowledging that his agenda had changed sharply just in the month since he was elected, Obama said passing a short-term economic stimulus package was now his top priority.

But stock market investors heard what they wanted to hear. What they wanted to hear was this.

President-elect Barack Obama has warned that "things are going to get worse before they get better" as he outlined details of an economic stimulus package that could reach $1 trillion and is designed to lift the United States out of recession." . . .

He proposed government programmes for bridges, roads, broadband internet and schools as well as plans for greater energy efficiency and health spending. The National Bureau of Economic Research has said that America has now been in recession for a year.

Although he played down expectation for a quick economic recovery, Mr. Obama said his plan was "equal to the task" that the US faced.

Let us add up these figures. He is proposing a trillion dollars of new spending.

Noting the US budget deficit might exceed $1,000bn even before his campaign promises and new spending plans were taken into account, factored in, Mr Obama said: "We understand that we've got to provide a blood infusion to the patient right now to make sure that the patient is stabilised.

"And that means that we can't worry short term about the deficit. We've got to make sure that the economic stimulus plan is large enough to get the economy moving."

The article went on to say that he has not announced an exact figure for increased spending.

Mr Obama has not put a full cost on his plan but his advisers estimate it will be more than $700 billion and could even top to $1 trillion.

But, we have been assured, there will be no pork this time. Congress will lay off the pork. An extra trillion dollars to go for state roads, bridges, and infrastructure, but there will be no pork.

JAPAN, 1990

We have seen all this before. The Japanese government resorted to infrastructure spending and a decade of fiscal deficits to deal with the recession of 1990. It had been produced by the easy money, low-interest rate policy of the central bank. The bubble burst in December 1989. At that time, the Nikkei stock index was over 39,000. Today, 19 years later, it stands a little over 8000. That is a 79% decline, plus two decades of forfeited income.

The solution of Japan was to hide the so-called zombie loans of the zombie banks. That is not Washington's way. The banks' losses have been laid out for all the world to see. Then Congress engineered a series of bailouts to allow huge banks to be absorbed by larger banks. Number-four Wachovia was almost absorbed by number-one Citigroup in late September. Two months later, Citigroup was within a weekend of bankruptcy. The Treasury Department bailed it out.

Zombie banks. Zombie loans. Zombie taxpayers. It's the year of the living dead.

Yet Obama's announcement of Japan II sent London's FTSE up by 6% on Monday. Germany's DAX was up 8%. The Nikkei was up by 5.2%.

The optimism of investors seemed complete when the U.S. stock exchanges opened on Monday morning. Up went the Dow by over 300 points: 3.6%.

The faith of investors in the Federal deficit is complete. What if there is a $1.5 trillion increase in fiscal 2009? What if there is $2 trillion? No problem!

But there is a problem: the source of the funds.

Obama's website says that he will push for a tax cut for 95% of American workers.

Cut taxes for 95 percent of workers and their families with a tax cut of $500 for workers or $1,000 for working couples.

Provide generous tax cuts for low- and middle-income seniors, homeowners, the uninsured, and families sending a child to college or looking to save and accumulate wealth.

Eliminate capital gains taxes for small businesses, cut corporate taxes for firms that invest and create jobs in the United States, and provide tax credits to reduce the cost of healthcare and to reward investments in innovation.

Dramatically simplify taxes by consolidating existing tax credits, eliminating the need for millions of senior citizens to file tax forms, and enabling as many as 40 million middle-class Americans to do their own taxes in less than five minutes without an accountant.

So, as far as we can see, there will be lower taxes. Unless Obama has become a devotee of what President Bush I dismissed as voodoo economics, he knows there will be falling revenues.

There is also a recession in progress. Recessions reduce profits and therefore lower corporate tax revenues.

This raises a question: Where will the extra $1.5 trillion to $2 trillion come from?

There is the bond market. The Treasury must not only roll over at least one-third of its $10 trillion debt, it must also sell an additional $1.5 trillion, minimum. What will happen to interest rates?

In a recession, Treasury rates may remain low. Money that would have gone into stocks, corporate bonds, small business loans, and real estate will go into the Treasury. But when the recovery begins, T-bonds will be sold, and investors will shift to stocks. That will drive up rates, cutting short the recovery. American stocks will fall. Again.

Then there are Japan, China, Russia, and the oil-exporters. Russia and the other oil exporters will be hurting from low oil prices. Japan and China export manufactured goods. To generate sales, they lend money to Americans to make these purchases. The trade deficit is about $750 billion per year.

The basis of hope in the recovery is that the recession will frighten investors so badly that they will stay in Treasury bills, where there is no hope of capital gains, merely a little loss.

The other hope is a continuing trade deficit.

What else? Federal Reserve inflation.

In August 2007, the first month of the credit crisis, its assets were at $900 billion. As of December 3, 2008, this stood at $2.17 trillion. That increase was funded by fiat money: an increase in the monetary base. This was just the beginning. The FED has announced the following loans:

1. $200 billion in student loans
2. $100 billion for Fannie Mae and Freddie Mac
3. $500 billion to cover in the two F's holdings of mortgage backed securities
4. $306 billion (at least) for bad loans of Citigroup

The Treasury says that the government must force down mortgage rates to 4.5%. That will take a lot of new money.

The Treasury has taken over $5 trillion in bad or questionable assets. The FED had absorbed over a trillion and a half, counting $406 billion in swaps of Treasury debt for toxic waste held by the biggest banks.

Then where are we? Here, says Prof. Rozeff.

The bad loans remain hidden and submerged within banks and other institutions. This paralyzes lending. The weak companies and poor managements that should be quickly cleaned out instead are given taxpayer money.

With public debt rising, the interest costs of the national debt rise. Capital that should be going to healthy enterprises is diverted to government and to zombie enterprises. Inefficient enterprises are subsidized.

Serious inflation looms larger and larger as a long-term problem.

The capital markets become dependent on Fed loans, and it is not clear how that dependence can be ended.

The government takes ownership interests in the most major banks, inducing further inefficiency in these semi-nationalized firms and threatening control of the allocation of capital. In this regard, the government policies have already fostered an undue concentration of assets in large banks. The three largest banks in the U.S. now have 38% of all large bank assets as compared with 27% in 2003. Banks with over $300 million in assets grew by 64% in the last 5 years, which is a very high per annum number, but the three largest banks grew by a still higher 130%.

In short, the actions of the government and the Fed are throwing a giant monkey wrench into the operations of banks and capital markets in intermediating capital from savers to businesses. The likely result is a prolonged slowdown in economic growth and more government control over the economy.

Put another way, America has become Oldsmobile Nation.

CONCLUSION

The world we grew up in has been lost since August 2007. The man who saw this coming and warned about it, Dr. Kurt Richebächer, died that month. He had predicted the worst capital crisis in our era. This is what it is becoming.

Investors are Keynesians. They believe that policies like these got America out of the Great Depression. They didn't. World War II did, because 12 million male workers went into the military, because tax revenues quadrupled (the withholding tax), because the Federal Reserve pumped in money, and because the government declared price controls and rationing. Real wages plummeted, yet patriotic people worked for rationed peanuts "to support our troops."

Nobody is willing to support our troops with self-restraint today. That world is long gone.

Inflation is coming. Then controls. Then rationing.

This is the future of Oldsmobile Nation.

December 10, 2008

Dow 5,000, Gold 2,000, Interest Rates Zero

Date 16/12/2008 By Bill Bonner

Today could be a big day. The Fed could make history – cutting rates down to zero.

So far, the feds have tried trillions worth of stimulation techniques. But the economy seems strangely indifferent. Unresponsive. Frigid, even. Every week brings more evidence that the animal spirits that are supposed to make it frisky and full of life are completely missing.

More layoffs, more bankruptcies, more frauds, more incompetence, more bad news...day after day...

Yesterday, for example, the Dow lost 65 points. And it was reported that houses lost more than $2 trillion of value in '08.

What can the feds do? They've cut rates...they've bailed out...they've lent...they've bought...they've sent out checks. Altogether, the bill for all this stimulation is stretching up to $9 trillion. But so far, all the stimulus has gotten us nowhere.

But the feds aren't going to give up. Nosiree. They have no other theory....no other idea...no other concept that those given to them by Keynes, Friedman and Gono: Spend, Cut Rates, Print money.

Today, the Fed will cut rates – maybe 50 basis points...maybe the whole enchilada...the entire 100 basis points they have left.

Yesterday, we urged you to sell the dollar. We hope you followed our advice. The dollar is falling. It's at a 13-year low against the yen. And it fell to $1.36 against the euro yesterday. Against gold, it lost another $16, bringing the price of the yellow metal to $836...an 8-week high.

What a delight! Our Trade of the Decade is now in profit on both ends. 'Sell stocks, buy gold' has been our advice for the last 8 years. This year, the 'sell stocks' half has done beautifully...but the 'buy gold' part looked a little tired. But lo and behold, cometh the Christmas season and Santa Claus comes around; gold begins to shine again. It is now UP for the year! Only about 1%...but at least it's in positive territory.

What else is up for the year? We can't think of anything. Once again, gold has come through. Ol' reliable.

And today, the Fed only has 100 basis points left. It will probably cut half of them. But it might go for broke by cutting all hundred. Never before has it cut rates to zero, but heck...never before has it been confronted with a global depression.

This is not just a recession and a bear market, says Bill Gross, this is a "transgenerational" downturn. Gross manages the largest bond fund in the world, PIMCO. He believes stocks are well priced. Measured either by P/E or the Q Ratio (price compared to replacement costs) US stocks are at a historic low, he says, "implying extreme undervaluation."

This is not normal. But then, neither is the circumstance. Government is muscling into the economy...pushing out private business. Government borrowing will take up almost all of the world's savings next year. Next year will bring more regulation too. Cheap financing is gone...and the elites are turning against free-market capitalism and globalization. In this new world...government spending "crowds the private sector into an awkward and less productive corner," says Gross.

What is the appropriate level for stocks in this world, he wonders. Dow 5,000? He raises the question, but doesn't answer it. So, we will answer it for him.

Yes, Dow 5000...it's coming. And gold 2000.

*** Here at the Daily Reckoning we have a different theory entirely. It's not our invention...but we like to take credit for it anyway. We saw the crisis coming not because we have better eyes, but because we are able to stand on the shoulders of giants: Adam Smith, Adam Ferguson, Jacques Rueff, Friedrich Hayek, Murray Rothbard, Josef Schumpeter and Kurt Richebacher. Not that we've done a thorough study of the field. It's just that there is something so transparently superficial about the Keynesians and the Friedmanites...not to mention the Gonoists.

At the bottom of it, we don't think the economy works like a machine. You can't tinker with it to make it run better, in other words. You can't turn a screw to eliminate mistakes. And you can't trick consumers into thinking they have more money – at least, not without adverse and unexpected consequences.

No, in our mind, an economy is a living thing...organic...natural...subject to moral laws rather than mechanical rules. In our theory, people don't get what they want or what they expect...they get what they've got coming. Sooner or later.

Of course, that's why economists, government planners, and world improvers don't much care for our pensée. The clumsy mechanics have their own jackass theories; they stick with them no matter how many times they prove not to work.

*** A remarkable issue of Newsweek offers advice to the president elect:

"How to Fix the World" promises the cover.

What makes the magazine remarkable is that it has managed to put between its covers more claptrap ideas and silly 'blah, blah' humbug than we ever saw assembled in one place.

Of course, you know what's coming when you read the headline. If you're going to "fix" the world, you must believe that there is something wrong with it...and that if the Obama administration would listen to the editors of Newsweek, it would be improved. We know you can fix a fight...or fix an election...or even fix a flat tire. But whenever people want to fix the whole world, they are looking for trouble. What they really mean is "change" the world – bend it into a new shape, more to their own liking...but hideous to everyone else.

"The world needs smart management," say the editors. No kidding. That's shows the height of bar Newsweek editors set for themselves. But what is "smart management?" And why should tomorrow's managers be smarter than today's?

And how is it possible to manage the world anyway? If the editors would only reflect for a minute they would realize that so far the "management" of the global economy has been disastrous. The last thing the world needs is more of it.

"Foreign policy requires adult supervision..." is another of the newspaper's empty bon mots. Who do they have writing this stuff, we wondered? Tom Friedman maybe.

Then, in a piece entitled "How to save democracy" the authors suggest "technical assistance" and "training programs" setting "clear conditions" before the US gives away any more money. They think that if foreign governments promise to work on "women's rights" and "transparency," the world will be a better place.

Tom Friedman must have had a hand in this, we conclude. It is all so childishly simpleminded. 'Democracy is a good thing,' the editors must have said to themselves, 'What can we do to get more of it?'

You see, dear reader, it's the same kind of drivel that you find in economics. 'Credit is a good thing; how can we get more?' Or, 'consumer spending makes the economy grow; how can we get consumers to spend more?'

The Newsweek team even offers to "fix Islam." Again, we didn't know there was anything wrong with it. But here is where we begin to get in the spirit of this whole world fixing scheme. It's a shame they don't turn their attention to Christianity. How could that be fixed, we wonder? For example, maybe the 10 Commandments could be lightened up, so as not to exclude so many people. How about just 8 Commandments...or 5...so they are easier to remember? Or, how about "Thou shalt not commit adultery very often?" Or, "thou shalt honor thy father and mother except when they are annoying?" See how easy it is to improve someone else's religion? Maybe they could go right to the heart of the Christian dogma and improve "Love Thy Neighbor" to "Like thy Neighbor." That would make the whole thing a lot easier to live with, don't you think?

Now that we're in the mood to fix the planet, we will take up Newsweek's next challenge with greater grace. Yes, dear reader, the magazine wants to fix relationships between men and women. They don't seem to like it when women wear those black outfits that cover them from head to toe, for example.

Now here is where we can make common cause. We don't like those black outfits either...except on women who look dreadful. But we don't know which women look dreadful and which don't, so we will make a suggestion; let's fix this black bag thing with the following edict: women's clothing should be inversely proportional to their age and beauty. The more young and attractive they are, the less they should wear. There...that should help!

And while we're at it, we humbly and respectfully propose a simple code of 'rights' for women: women should be able to do anything men can do...only better. Except chew gum in public...we draw the line there. We hate to see a woman chewing gum... or swearing. Women should never swear; it makes them sound like sluts or low-bred washerwomen. Also, since we're taking the initiative here, women should wear dresses. We know this will seem a bit retrograde, but sometimes you have to go back before you can go forward. We like to see women in dresses, and we are sure it will be a better world if women wore dresses...except, that is, for the women who wear black bags.

But we're probably going a bit far afield from the world improvements the Newsweek team had in mind.

Let's return to their agenda.

"Markets can't rule themselves" says Joseph Stiglitz. We need "better regulation," he says. Now there's a novel idea. The SEC was set up by the Roosevelt administration 70 years ago. They were actually watching over Bernie Madoff's company...and actually did a review of it in 2005 and 2007. Somehow, these ace regulators didn't notice the biggest ponzi scheme in world history...a scheme approximately 5,000 times bigger than the scheme of the eponymous Ponzi himself.

Better regulation? We know how to get more regulation. But what we don't know is how to get better regulation. We don't even know what it means. There were thousands of regulators on the job in New York City. Not one of them seems to have caught on to any of the great scams that were going on. Even when they were so obvious even we poor scribblers here at the Daily Reckoning warned about them for years. We said sub-prime would be a disaster. We told the world that hedge funds were a rip-off. We whined about high executive salaries and bonuses. We explained how the profits going to the financial industry were an aberration. We laughed at the pretentious nonsense of the investment engineers, the pious complicity of the rating agencies, and the reckless greed of the mortgage lenders. Housing...finance...private equity...hedge funds...the dollar – what did we miss? And a subscription to the Daily Reckoning is free!

Newsweek presses onward in its delusions:

"More government is the solution" says Brazil's President Lula da Silva. The solution to what? We would like to know what problem – that was not caused by government itself -- has ever been solved by government. We can't think of any. But so the magazine lurches on...from one bit of claptap to another...from mass delusion to popular fantasy...from farce to dada.

*** Poor George Bush. At a press conference in Iraq, a journalist called him a dog, in Arabic, and then threw his sized-10 shoe at the president. Dubyah ducked.

What's wrong with America's journalists, we wonder. Have they no shoes?

Flowery Dreams

Like all boom and bust stories, not everyone lives happily ever after in Tulip Fever

by Doug French

"The boom produces impoverishment," wrote Ludwig von Mises in *Human Action*. "But still more disastrous are its moral ravages. It makes people despondent and dispirited. The more optimistic they were under the illusory prosperity of the boom, the greater is their despair and their feeling of frustration."

As the world-wide boom has turned into a world-wide crash, it's not just financial dreams that have been dashed. Families have been torn apart, relationships busted and some men learning that their boom-time marriages were contingent on "for better" lasting forever, and their now ex-wives aren't waiting for Hank Paulson or Ben Bernanke's stabilization schemes to work.

Not only are economic signals distorted by boom times, but all human action can be warped. Morals and good sense are cast aside. The good times will never end; caution and prudence are no longer required, hubris runs wild. As Paul Cantor describes Thomas Mann's short story "Disorder and Early Sorrow" set in hyper-inflationary Weimar Germany: "The story charts the dissolution of authority, as we watch a social order breaking down and see the confusions that result."

As rare as Thomas Mann's short story, are historical novels using financial manias as a backdrop. But it wasn't the frantic trading of tulip bulbs that inspired author Deborah Moggach to write *Tulip Fever*. It was a 1660 painting by a minor Dutch artist that she bought at auction. In her research she quickly discovered tulipmania and "thought this a wonderful symbol of human greed and passion," she writes on her website.

In very fast moving fashion, Moggach tells a tale of passion and deception. Set in 1630s Amsterdam, the author captures that city's frenzy of commerce. All strata of society were living it up. The very wealthy merchant Cornelis Sandvoort has a fine home, servant, pretty young wife, but no heirs. He like many of Amsterdam's high society seeks immortality with a portrait painted by one of the many busy local artists.

But his dear Sophia has lost her passion for him, and falls for the advances of the young artist her husband commissions to paint their portrait. As the portrait progresses, so does the forbidden love affair, with the lies multiplying like the price of Witte Croonen bulbs.

As they become more and more brazen with their affair, Sophia's and her paramour painter's lives become entangled with those of Cornerlis's servant girl Maria and Maria's dockworker lover Willem. In Jan van Loos, Sophia's lover, Moggach effectively portrays a man caught up in a mania. He begins to neglect his work, be negligent in his grooming, and be totally obsessed with trading tulip bulbs. He leaves his painting entirely to his apprentice. He has great success trading and then hatches a plan to mortgage everything to raise the money needed for Sophia and him to run away together. In Sophia's voice, "I meet Jan in our trysting place beside the water fountain. He has lost weight, his cheeks are sunken. His hair, so shiny and curly when he first came to my house, is matted. He doesn't greet me; eyes glittering, he grabs my wrist."

Jan to Sophia "Luck's been on our side, all these weeks. Tell me we should put all our eggs into one basket!"

"He means, of course, the risk beyond all risks: the most dangerous risk of all. The king of kings, the Semper Augustus. Claes van Hooghelande has one bulb left."

Moggach brings tulipmania to life and continually surprises the reader with an imaginative plot. Imaginative enough that Steve Spielberg called the author before the book was even published in 1999 and said he wanted to film it.

There is plenty on the internet about the cast: Jude Law is to play Jan van Loos and Keira Knightley will be Sophia. Unfortunately, Spielberg hasn't gotten around to making Tulip Fever into a movie.

Like all boom and bust stories, not everyone lives happily ever after in Moggach's tulip tale, but it is anything but predictable and a very fun and instructive read. *December 16, 2008*

Doug French [send him mail] is executive vice president of the Ludwig von Mises Institute and associate editor for Liberty Watch Magazine*. He received the Murray N. Rothbard Award from the Center for Libertarian Studies. See his tribute to Murray Rothbard.*

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Madoff and the Failure of the SEC

Daily Article by Briggs Armstrong | Posted on 12/18/2008

Few Wall Street gurus or members of the financial press, if asked on December 11, would have said that the news of Senate Republicans spurning Bush and killing the automotive bailout would not be the next day's top headline. They would have been sadly mistaken.

News broke on December 12 that Bernard Madoff, former chairman of the NASDAQ stock market, was arrested for committing fraud. This was not in the form of some minor chicanery, but a fifty-billion-dollar scam. Lest the reader think that the word scam is too harsh, I will put it in Madoff's own words; he referred to his operation as "all just one big lie" and "basically, a giant Ponzi scheme."

For those unfamiliar with the nature of a Ponzi scheme, it relies on funds from new investors to pay falsified, and abnormally high, returns to existing investors. As Madoff demonstrated, as long as there is sufficient money coming in, it can reach massive proportions and continue for years.

Madoff managed to lure billions of dollars away from huge charities, as well as wealthy individuals in both the United States and Europe by getting them to invest in his hedge fund. He did so by claiming extraordinary returns (generally in the low double digits). His scheme eventually reached a staggering $50 billion under "management." This all came crashing down around him after market conditions led to a considerable amount of redemptions (investors asked for their money back).

Hedge funds are different from mutual funds in many respects. Most notably, hedge funds are not burdened by the same government regulatory requirements that mutual funds are. They also generally have much different compensation structures and considerably higher barriers to entry for potential investors. Due to hedge funds' relative freedom from excessive government intervention and regulatory burden, they are often able to generate higher returns than the average mutual fund; indeed, most mutual funds underperform compared to the S&P 500 benchmark.

As shocking and unprecedented as this scandal is, many in the financial press are beginning to ask "Where was the SEC?" This is perhaps the most important lesson to be gleaned from this tragedy, which has left countless bankrupt. It seems that everyone wants to know how anyone could be so clever as to run a fifty-billion-dollar Ponzi scheme without the SEC — which has seemingly limitless power and resources at its disposal — ever noticing. After all, if the government couldn't protect people who could? The answer is simple: the free market.

This is not a case in which free-market proponents are forced to theorize countless what-if scenarios regarding a solution that would not involve the government. The free market did spot the problem; it even reported it to the SEC. Perhaps unsurprisingly, all of the warnings were ignored by the SEC, which failed its fiduciary obligation to investors.

Due to the lack of government intervention and regulation with respect to hedge funds, consumers demanded some sort of policing of hedge funds in order to protect investors who lack the knowledge or resources to properly investigate the funds in which they plan to entrust their money. The free market responded to the consumer demand and so-called "due-diligence firms" emerged. Individuals seeking to invest in a hedge fund frequently pay one of these due-diligence firms for their opinion about specific hedge funds.

Due-diligence firms use the fees collected from their clients to hire professionals to meticulously review hedge firms for signs of deceit. One such firm is Aksia LLC. After painstakingly investigating the operations of Madoff's operation, they found several red flags. A brief summary of some of the red flags uncovered by Aksia can be found here. Shockingly, Aksia even uncovered a letter to the SEC dating from 2005 which claimed that Madoff was running a Ponzi scheme. As a result of its investigation, Aksia advised all of its clients not to invest their money in Madoff's hedge fund.

This is a perfect case study showing that the SEC is incapable of protecting investors as well as free-market institutions are. The SEC is becoming increasingly irrelevant and people are beginning to take notice. It failed to save investors from the house of cards made up of mortgage-backed securities, credit default swaps, and collateralized debt obligations that resulted from the housing bubble. Now it has failed to protect thousands more individuals and charities from something as simple and old as a Ponzi scheme!

It seems that this event will place people into one of two camps. Either people will be disillusioned with the SEC and realize that the only function that it seems to be able to do well is to stand in the way of the free market's self-policing mechanism, or they will come to the erroneous conclusion that there is too little regulation and that the SEC needs more power to protect investors.

I fear that the latter will be the majority, but even so, many will come to see that less government is the real way to protect people. Tragically, it is in the nature of government, when its failures are exposed, to claim that if only it had more power it could have performed its duties in the manner it had promised.

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