

APRIL 2018

# BANKNOTES

NELSON NASH MONTHLY NEWSLETTER

## CONTINUING TO PONDER—AND RUMINATE

by R. Nelson Nash

In last month's issue of *BankNotes* newsletter, I wrote an article entitled *Something to Ponder*. As a result, for all month long, I have been doing a lot of pondering and have concluded that this is a vast undertaking that should be practiced by everyone.

Why are people—you and I—behaving the way we do? When considering how people think—which is the root cause of behavior—it is easy to conclude that our world is dominated with absolute nonsense and, as a result, irrational behavior.

Several years ago, I was conducting an Infinite Banking Concept Seminar in Western Colorado. The sponsor of the event assembled his audience and said, "The Infinite Banking Concept is all about how you think. It's all about how you think. It's about how you think!"—and then he introduced me. It was such an effective—and truthful—way to start the seminar that I adopted the phrase in all speaking events and it is expressed—or implied—in all writing that I do.

To make sure we don't get off track in this forthcoming series of articles that I will be offering maybe a good place to start the subject at hand is with definitions—just what is pondering all about? It is a very special dimension of thought process. Merriam-Webster says, "to think or consider especially quietly, soberly, and deeply." Of course, all other definitions offered are slight variations of this one, so let's just go with this one.

Closely allied with ponder is the word ruminare. Relying on Merriam-Webster again, "to go over in the mind repeatedly and often casually or slowly." Understanding the meaning of this word and engaging in this action is extremely important if we are going to make any progress in our lives because of what I described in the second paragraph of this article. We need to be able to recognize nonsense when it appears and dispense with it immediately!

At the end of last month's *BankNotes* article, I alluded to a forthcoming follow-up article about pondering. And so, after a month of engaging in my own recommendation I have decided that "a follow-up article" just won't suffice for such a vast subject. It is going to have to be an on-going work for the rest of my life. Lots of articles. Maybe it will end up becoming a book.

## IN THIS MONTH'S ISSUE:

- [Continuing to Ponder-and Ruminare](#)
- [Why Banking Is No Ordinary Industry](#)
- [Trade Deficits and Fiat Currencies](#)
- [3 Economic Fallacies That Just Won't Die](#)
- [Trade and the Rise of Freedom](#)
- [The Looming Mortgage Liquidity Crisis](#)
- [Why Passionate Educators Should Consider Leaving Academia](#)
- [How the Founder of Dell Convinced His Parents It Was OK to Quit College](#)



NELSON  
NASH  
INSTITUTE

2957 Old Rocky Ridge Road  
Birmingham, Alabama 35243  
BankNotes archives:  
[infinitebanking.org/banknotes](http://infinitebanking.org/banknotes)

*Founder*

Nelson Nash  
[rnnash31@gmail.com](mailto:rnnash31@gmail.com)

*Editor*

David Stearns  
[david@infinitebanking.org](mailto:david@infinitebanking.org)

Who knows? We shall see.

You may remember that Leonard E. Read—the one who established The Foundation for Economic Education—was my friend and mentor. He led me to 61 years of passionate study of the Austrian School of Economic thought. Leonard wrote for busy people. You could read one of his articles in fifteen minutes or so—and “chew” its subject for a week. He would cause you to think! To ruminate!

Some months later a new book of his would appear. It would be a compilation of those articles that he had written over an arbitrary time frame, all of which followed a general theme.

Dr. Clarence B. Carson was my second mentor and special friend. I met him through The Foundation for Economic Education, also. He was a historian and wrote from an economic point of view. His book, *The World in the Grip of an Idea* made a profound effect on my life. It was first published serially—one chapter per month—in *The Freeman*, a monthly journal of FEE. I think it took a couple of years in this format to complete it. And then it became a hard cover book. I've read it at least four or five times.

This idea that Carson addresses has lots of common names, Socialism, Communism, Fascism, Group Think, Democracy, etc. You name it. Maybe we could call it “Monkey see, Monkey do.” All of them have a common characteristic—“Top Down Thinking.” Within the animal world it is easily observed that there is a “pecking order.” One animal dominates the community in which it lives and all the others just submit to the “leader.” Are we all that more advanced than the animals?

With this foundation of pondering and ruminating let's get started with just one phenomenon that is vital to us in the financial world—the matter of “Fractional Reserve Banking.

Huesus Huerta de Soto on page 118 of his book, *Money, Bank Credit, and Economic Cycles* writes “...that the nationalization money and the central bank's regulation of the banking system and its laws governing it have been incapable of maintaining a

stable financial system that avoids economic cycles and averts bank crises. Thus, we may conclude that the fractional-reserve banking system has failed as well, even though it is backed and protected by a central bank.”

What is not acknowledged here is the fact the fractional-reserve system is all one gigantic LIE! If such an activity is properly classified then behavior changes. Why were there no challenges?

deSoto continued “... even though it is backed and protected by a central bank.” In the USA we call it The Federal Reserve Bank. THAT IS AN EVER-BIGGER LIE! It is not Federal. There is no reserve. It is not a bank. It is a cartel of deceptive banking people—and citizens do not have the courage to challenge them with truth!

This all reminds me of a story that Leonard Read told. “There was this man who was totally convinced that the prevailing explanation of our solar system was wrong. That the earth was the center of it all and that the sun and the moon orbited around it. The earth was revolving on an axis that rested on the back of a giant turtle.

Someone asked him ‘What is the giant turtle resting on?’ ‘An even bigger turtle.’ he replied.

“So, what is that turtle resting on?’ “An even bigger turtle than that—you see, it's turtles all the way down!”

And so, we have lies that are supported by even bigger lies.

If we change the word—turtles—to LIES, then the analogy is complete. My observation is that we live in a world of lies. This is particularly true of our financial world. On our website, The Nelson Nash Institute, under the Resources Tab there is a recommended reading list. There are over 150 history books that support my belief.

Learning how to recognize a lie—and how to effectively challenge it—is a skill that we all need to accept as a lifetime work.

Ponder on! Ruminating! We will take up another lie next month.

## Why Banking Is No Ordinary Industry

by Ryan Griggs

Have you ever wondered what you ought to do with the money you make? If so, you aren't alone.

Recent college graduates, many of whom have had little to no experience in managing an income, find themselves in the awkward position of having to do something with it; that is if we suppose they actually *find employment* in the first place.

The problem of what to do with the money we make has literally existed for centuries. However, the issue isn't totally opaque. It doesn't take a financial genius to know that some portion of income should be — must be — spent on life's necessities, e.g. food, clothing, and shelter.

But what happens when there's some money left over?

It's an odd problem to have. We're all told that to get rich requires *earning more than you spend*. The remainder should be *saved*. But what's that mean? Cash under the mattress? Leave it in the bank account? Shares of publicly traded stock? Or maybe a mutual fund?

Discussions about what's best typically revolve around *rates of return*. Where can my money make the most money? How do I best *invest* what I earn? After all, "everyone knows" that you can do something better than just *hoarding* the money. We're told to "put it to work." And fair enough, we work hard for our money, shouldn't our money work hard for us?

Notice the change in language. We've gone from the importance of saving to the best way to invest. Is this an innocuous shift?

I want to suggest to you that it's not. In fact, the focus on investing has a peculiar similarity to the old adage of "missing the forest for the trees."

### The Special Privileges of Banks

In your work, do you have a colleague, boss, or client who just "makes your life easy"?

Society's financial focus on the investment trees at the expense of the economic forest makes the lives of those in a particular industry especially easy.

*That industry is banking.*

A banker's life is made pleasant almost to the point of effortlessness. The language and form of conversations about money facilitate this ease of existence. You see, the foundation of a bank's profitability consists in the deposits folks like you and I grant to them.

It goes like this, banks make money by charging interest on loans. Banks have a unique, legal privilege to originate loans at a *multiple* of its deposits. That means that every new dollar in deposits allows a bank to originate more than a dollar in new loans.

See, you might think that banks lend your money. Now, it's technically impossible to trace what happens to those particular dollars you deposit with a bank. At the end of the day, what matters to a bank is *leverage*. Banks don't just lend out the dollars they receive from depositors. Far from it. They take those deposits, multiply by a factor, e.g. 10, and lend out *that* amount.

So it's not that banks lend your money. They lend out *far more* than just "your" money.

How do they do that? What would happen if you or I made a loan to someone else with money that we never received from someone else first? How could such a thing even be possible? Well, for you and I, it's not possible, at least not legally. Profiting by using money we ourselves created is called *counterfeiting* and it can come with a prison sentence.

But not for the banks. In the technical language of economics, we call this process of legal counterfeiting "inflation." The euphemistic definition of "inflation" is "an increase in the quantity of money." The thorny ethical question as to the origin of that increase is conveniently set aside.

Are you starting to see the forest?

The more deposits a bank has, the more legal counterfeiting (“lending”) it can do. The more “lending” it does, the more interest it will collect. The more interest it collects, the more profitable it becomes. The more profitable it is, the more property over which it can exercise control — like politicians.

How do you receive income? Direct deposit? A paper check? To where is that income destined?

*A bank.*

How do you imagine bankers feel about that process? It's like asking, “how would you feel about a client or colleague that makes your life easy?” Words like spectacular, tremendous, blessed, fulfilled, and content come to mind. However, the question is a bit off. It's more like, “how would you feel about a client or colleague who not only makes your life easy, but makes it 10 or 50 times more profitable than it was before?”

This wouldn't be so bad if you still *owned* money you deposited in the bank. At least if it was legally *yours*, you could demand it back whenever you wish. However, it would be in the *bank's* interest for *the bank* to own your deposits. That way, if they were ever to get into a situation where they didn't have enough money on hand to fulfill your withdrawal request, they could just *deny* the request.

Unfortunately, you *don't* own the money you deposit in a bank. The *bank* does, and this is reinforced by *Dodd-Frank*. Of course, banks don't typically refuse withdrawal requests. If they did, people might object to sending them fresh new deposits. This technicality of legal ownership is an *ace up the sleeve* of banks. No banker plays that card unless he must.

It's an ugly forest, isn't it?

Suppose you don't *keep* money in the bank. Your high school teacher, whose financial acumen credentials are unknown, if they exist, has done his duty and you've listened. “You should be investing! And start young!”

What sort of business would a bank be if it had no

solution for the prudent student of finance? Shares of stock and government bonds, cloaked in a veil of indecipherable financial lingo, buried in stacks of paper, enumerated in eight-point font, dressed up in super official, authoritative language, are available to help you “prepare for your financial future.” A smooth-talking, well-dressed, *personal wealth adviser* is available to help you select the best option (for whom?).

The hard-working, well-intended bank customer has, by now, been sufficiently (a) mystified and (b) steam-rolled by the opulence and polite manner of the whole experience. Well, *the experts know best*, right? Better to go with their recommendations, rather than to “go it alone” — or so they say.

Now that the forest is more fully in view, we can discuss some of the features of this business, or *racket* — depending on which side of the table you sit.

Notice the core around which the banking — and all financial — business revolves. *The flow of money*. You might think of it as *cash flow*. This term is typically, and sadly, reserved for discussions about the revenue and expenses of a business. But in reality, the flow of money, or cash flow, is a feature of everyone's financial experience. The flow of that money, the *velocity* and *direction* of it, in particular, is the determining influence behind the form and function of the financial industry.

How does this relate to money?

Consider that *money flow* is the key ingredient to *economic activity* just in the way *water flow* is the key ingredient to *biological activity*. Money flows through *banks* just the way water flows through *rivers*. However, whereas the flow of water is determined by the laws of physics, the flow of money is determined by the *choices of men* (and women). And unlike nature, where matter is neither created nor destroyed but only transferred, *money can be conjured* when backed with sufficient force of government through special legal privileges.

The result is a *literally unnatural, disproportionate*

flourishing of economic activity around those institutions where new money is conjured through the exercise of legal privilege. Therefore, it is no wonder that the bankers and money managers are unnaturally, disproportionately wealthy.

With water, man is limited in his capacity to influence its flow. The oceans are vast and water's flow and erosive power are tremendous. The best we can do to change its flow is a dam here and a levy there, each of which is ultimately at the mercy of a complex atmospheric system.

Man's odds with affecting the flow of money are categorically different. Man *chooses* where his money flows. The priestly power of banks rests on the *decisions* of men. Banks specifically require a stable, relatively predictable flow of new deposits, each kept with the bank — or at least within the banking system — for a stable, relatively predictable length of time.

So long as men remain docile, submissive, and complacent with respect to the banking class's legal privilege to conjure money where before it did not exist, the *economic landscape*, in its general form, will remain unchanged.

So long as men refuse to discuss the true *nature of the banking business*, and prefer instead to *leave it to the experts*, the chances men will *think differently* are nil.

The forest is clear. It's up to you to *do something* about it.

*Ryan Griggs is a business consultant. He blogs about finance, economics, and liberty on his Medium page.*

**Nelson's Book Recommendations**  
<https://infinitebanking.org/books/>

*How to Survive in the Pharisee Church* by Norman Walford <http://phariseechurch.com/>

## Trade Deficits and Fiat Currencies

Robert P. Murphy

[Originally published March, 2010.]

There is a connection between fiat currencies and trade deficits, and many cynics have argued that the US dollar's status as global reserve currency allowed Americans to consume more than they produced for decades. However, this "deficit without tears" argument is sometimes overstated. To gain a deeper understanding of both monetary theory and international trade, it's useful to probe the issue more carefully.

### Does Fiat Money Cause Trade Deficits?

In his book, *The Creature from Jekyll Island*, G. Edward Griffin is rightfully suspicious of the American trade deficit and the US dollar's special role in the world since World War II. He explains,

When the dollar was separated entirely from gold in 1971, it ceased being the official IMF world currency and finally had to compete with other currencies.... From that point forward, its value increasingly became discounted. Nevertheless, it was still the preferred medium of exchange. Also, the U.S. was one of the safest places in the world to invest one's money. But, to do so, one first had to convert his native currency into dollars. These facts gave the U.S. dollar greater value on international markets than it otherwise would have merited. So, in spite of the fact that the Federal Reserve was creating huge amounts of money during this time, the demand for it by foreigners was seemingly limitless. The result is that America has continued to finance its trade deficit with fiat money — counterfeit, if you will — a feat which no other nation in the world could hope to accomplish. (p. 93)

Griffin then explains the benefits to Americans from this arrangement. After all, it's not too shabby to import cars, clothes, and fancy electronics in exchange for green pieces of paper. Yet all is not bliss:

There is a dark side to the exchange, however.

As long as the dollar remains in high esteem as a trade currency, America can continue to spend more than it earns. But when the day arrives — as it certainly must — when the dollar tumbles and foreigners no longer want it, the free ride will be over. When that happens, *hundreds of billions* of dollars that are now resting in foreign countries will quickly come back to our shores as people everywhere in the world attempt to convert them into yet more real estate, factories, and tangible products.... As this flood of dollars bids up prices, we will finally experience the [price] inflation that should have been caused in years past. (p. 94, emphasis in original)

So far, I am largely in agreement with Griffin. But then he oversteps, or at least appears to, when he concludes,

The chickens *will* come home to roost. But, when they do, it will not be because of the trade deficit. It will be because we were able to *finance* the trade deficit with fiat money created by the Federal Reserve. If it were not for that, the trade deficit could not have happened. (p. 94, emphasis in original)

It's not clear whether Griffin thinks the trade deficit would have been literally zero if the United States had used gold as money throughout the 20th century, or (more likely) if Griffin merely means that in practice the trade deficit would have been much smaller.

Regardless of Griffin's particular stance, there are definitely some members of the sound-money community who believe that trade deficits would literally be impossible if all countries were on a gold standard. That's incorrect, as I'll argue in the next section. After that, I will reconcile my own demonstration with Griffin's quite valid linking of the fiat US dollar with unsustainable American trade deficits.

### **Gold Doesn't Prevent Trade Deficits**

One quick way to see a puzzle in Griffin's analysis above is that the reasons for the appeal of the US

dollar would only be *enhanced* by a return to gold. Griffin says that foreigners still esteemed the dollar over other currencies, and that the US was the safest place to invest money. If the Treasury or Fed credibly announced that henceforth the dollar would once again be redeemable for a fixed weight of gold, surely investors would flock to it even more so. It would be much safer to buy a government or even corporate bond issued in the United States knowing that the gold standard would restrain further dollar creation.

When economists compute the trade balance (or more accurately the current account), they don't include the sale of financial assets. So if foreign investors want to spend more (once we convert to a common denominator) on American assets than US investors want to spend on foreign assets, the trade balance is negative. The capital-account surplus is counterbalanced by a current-account deficit.

For example, suppose Americans buy \$9.5 trillion in stocks, bonds, and other financial assets from outside the United States, while non-Americans acquire ownership of \$10 trillion worth of stocks, bonds, and other financial assets from within the United States. This means the foreigners have on net gained \$500 billion of American wealth. Surely the foreigners need to do something in return, and indeed they do: they send Americans \$500 billion worth of cars, TVs, iPods, etc.

Tying the dollar to gold, or, better yet, abolishing the government's involvement in money and banking completely, would make the United States an even stronger magnet for foreign investment. It's possible that the absolute size of the trade deficit would fall (as we will explain in the next section), but it wouldn't disappear.

In fact, if the US government not only returned the dollar to gold, but also eliminated the IRS and slashed its budget, it's possible that the US trade deficit would mushroom. This would make perfect sense, as capital from around the world would flow to the new haven where its (after-tax) returns would be much higher.

In this scenario, aliens in space would see tractors, computers, factory parts, bulldozers, and crude oil flowing from all corners of the earth to the United States. If those aliens understood trade accounting, they would compute this massive net inflow of goods as an unprecedented trade deficit. But of course that is exactly what *should* happen if the United States (or any country) adopted free-market reforms and thereby became a much more hospitable arena for economic activity.

### Why Griffin Is Basically Correct

Even though a few of Griffin's sentences might lead one to draw faulty conclusions, nonetheless Griffin's analysis is basically correct. All we really did in the above section was show that a large trade deficit can be consistent with a healthy, productive economy. That's far different from saying a trade deficit is *proof* of a solid arrangement.

Specifically, the problem occurs because foreigners can invest in "American assets" to fuel either production or consumption. It's true, if the US government enacted the reforms discussed above, then foreigners would invest heavily in American industry. Corporations would float new bonds and issue new stock, and with the influx of funds they could rapidly expand their operations. In terms of physical goods, we would see heavy equipment and raw materials flowing from other countries into the United States, and these inflows of capital goods would constitute a large part of the rising trade deficit.

Unfortunately, there is another possibility. If the Federal Reserve creates hundreds of billions in new dollars out of thin air, and the foreign "investors" are other central banks that gobble up the dollars because their own rules treat them as reserves, then this increase in the foreign demand for "American assets" is of a much-different character.

In particular, the low US interest rates that accompany such a gusher of new dollars will encourage domestic consumption and will discourage foreigners in the private sector from investing in the United States. The rest of the world

will acquire American assets all right, but they will be more heavily tilted toward debt (rather than equity in growing companies). The physical goods flowing into the United States will be consumer goods such as TVs and iPods.

Griffin is perfectly correct that *this* type of mushrooming trade deficit is indeed unsustainable. Unlike the importation of tractors and crude oil, the influx of consumer electronics doesn't allow the US economy to produce more in the future.

The increase in foreign claims on US income streams therefore isn't a constant or shrinking portion of the growing American pie, but rather is a growing portion of a constant pie. It can be sustainable for the absolute dollar amount of US corporations' outstanding bonds to increase over time, so long as earnings and profits increase proportionately. But it is *not* sustainable if households and the government experience a rising debt-to-income level.

### Conclusion

There is a definite connection between fiat currencies and trade deficits. Critics of the Federal Reserve are right to blame it for distorting trade flows and setting the US economy up for an inflationary crash. However, a trade deficit per se is not a sign of a bad economy. Indeed the trade deficit might blossom if the US ever returned to the gold standard, though it would be due to a productive net inflow of producer goods.

### Nelson's Favorite Quotes

*"On the free market, it is a happy fact that the maximization of the wealth of one person or group redounds to the benefit of all; but in the political realm, the realm of the State, a maximization of income and wealth can only accrue parasitically to the State and its rulers at the expense of the rest of society."* - Murray Rothbard

*"The State, by its very nature, must violate the generally accepted moral laws to which most people adhere."* - Murray Rothbard

## 3 Economic Fallacies That Just Won't Die

by Luis Pablo de la Horra

In any academic discipline, one can find two types of experts: those who are incapable of explaining complex ideas in a simple manner; and those capable of making the difficult look easy. This year marks the 25th anniversary of the death Henry Hazlitt, one of the few economists who belongs to the second group.

Born in Philadelphia in 1894, Hazlitt developed his career as a journalist in the most influential newspapers and magazines of the country, starting at The Wall Street Journal as a typographer in 1914. During the 1920s, he wrote for several printed media outlets, including The New York Evening Post and The Nation, of which he was appointed literary director.

In 1934, Hazlitt became the chief editorial writer of The New York Times, where he gained a reputation for writing about economics and finance from a free-market perspective. His outspoken opposition to the Bretton Woods Agreement had him fired after 12 successful years at the most important newspaper of the Big Apple. Yet he continued to be dedicated to his passion for writing until his death in 1993.

Despite his lack of formal academic training, Hazlitt showed a deep interest in the field of economics, which led him to write several books on the topic. In 1946, he published one of the best introductory texts on economics ever written: *Economics in One Lesson*.

Following the steps of the 19th-century French economist Frédéric Bastiat, Hazlitt pointed out that short-sighted economic policies aimed at satisfying the claims of particular groups inevitably end up reducing the welfare of the majority of the population. In his own words,

“The art of economics consists in looking not merely at the immediate but at the longer effects

of any act or policy; it consists in tracing the consequences of that policy not merely for one group but for all groups.”

*Economics in One Lesson* is a magnificent rebuttal of popular economic fallacies deeply embedded in the political discourse of his time. By means of a very accessible language aimed at the general public, Hazlitt discusses, dissects, and debunks 22 economic sophisms like the idea that technological advances destroy employment or the myth that price ceilings are beneficial for consumers. All fallacies examined in *Economics in One Lesson* are still present in today's political debate. Yet there are some that are especially relevant for their implications on the long-term welfare of societies. Here are three of them:

### 1. The Protectionist Fallacy

Since at least Adam Smith, it is a well-known fact that free trade is one of the keys to prosperity. Yet the case for tariffs keeps coming back like a bad penny. In a few pages, Hazlitt provides a concise and yet comprehensive account of the detrimental effects of tariffs on real wages, consumers, and productivity. According to Hazlitt, this fallacy stems from looking merely at the short-term benefits of tariffs for specific groups disregarding their long-term impact on the economy as a whole.

### 2. The Minimum Wage Fallacy

The myth that lower classes benefit from minimum wage laws is another belief firmly rooted in the collective imagination of the public. Nothing could be further from the truth. When the government passes a law forbidding employers from paying workers less than, say, \$15 per hour, all workers whose marginal productivity doesn't reach that number will be condemned to unemployment. As put by Hazlitt,

You cannot make a man worth a given amount by making it illegal for anyone to offer him anything less. You merely deprive him of the right to earn the amount that his abilities and situation would permit him to earn.

### 3. Labor Unions Raise Wages and the Standard of

## Living

Another widely-spread fallacy has to do with the role of labor unions in determining real wages. According to the conventional view, labor unions play an essential role in settling the overall level of wages in an economy. In other words, most workers would be underpaid if unions didn't exist. It is true that labor unions can push wages above productivity in a particular industry in the short term.

However, the increase in labor costs will be likely passed to consumers in the form of higher prices, which will end up reducing the volume of profits of the industry as a whole. This, in turn, will result in lower wages and, ultimately, unemployment. Thus, labor unions cannot affect the wage level in the long term. For Hazlitt, the fallacy resides in overlooking the only source of long-term increases in real wages: developments in labor productivity as a result of "the accumulation of capital and the enormous technological advance made possible by it."

In a time when protectionism and minimum wage laws are on the front line of the political arena, the ideas of Henry Hazlitt should be vindicated as a means of fighting the basic economic fallacies of our time, which unfortunately have barely changed since the publication of *Economics in One Lesson*. Hazlitt taught us that, in economics, intuition is misleading and reasoning beyond the obvious is the only way to gain a deep understanding of the long-term consequences of economic policies.

Luis Pablo De La Horra holds a Bachelor's in English and a Master's in Finance. He writes for FEE, the Institute of Economic Affairs and [Speakfreely.today](http://Speakfreely.today).

**NNI's Live Seminars & Events**  
<http://infinitebanking.org/seminars/>

**The IBC Seminar, May 19, 2018 - Chicago**  
*For attendance information, click here*

## Trade and the Rise of Freedom

Thomas J. DiLorenzo

[This speech was delivered at the Mises Institute's conference on "The History of Liberty."]

It is not an exaggeration to say that trade is the keystone of modern civilization. For as Murray Rothbard wrote: "The market economy is one vast latticework throughout the world, in which each individual, each region, each country, produces what he or it is best at, most relatively efficient in, and exchanges that product for the goods and services of others. Without the division of labor and the trade based upon that division, the entire world would starve. Coerced restraints on trade -- such as protectionism -- cripple, hobble, and destroy trade, the source of life and prosperity."<sup>1</sup>

Human beings cannot truly be free unless there is a high degree of economic freedom -- the freedom to collaborate and coordinate plans with other people from literally all around the world. That is the point of Leonard Read's famous article, "I Pencil," which describes how to produce an item as mundane as an ordinary pencil requires the cooperation and collaboration of thousands of people from all around the world, all of whom possess very specific knowledge (of "time and place," as Mises called it) that allows them to assist in the production and marketing of pencils. The same is true, of course, for virtually everything else that is produced.

Without economic freedom -- the freedom to earn a living for oneself and one's family -- people are destined to become mere wards of the state. Thus, every attempt by the state to interfere with trade is an attempt to deny us our freedom, to impoverish us, and to turn us into modern-day serfs.

Mises believed that trade or exchange is "the fundamental social relation" which "weaves the bond which unites men into society."<sup>2</sup> Man "serves in order to be served" in any trade relationship in the free market.<sup>3</sup> Mises also distinguished between two types of social cooperation: cooperation by virtue of private contract and coordination, and

cooperation by virtue of command and subordination or "hegemony."<sup>4</sup> The former type of coordination is symmetrical and mutually advantageous, whereas the latter is asymmetrical -- there is a commander and a commandee, and the commandees are mere pawns in the actions of the commanders. When people become the mere pawns of their rulers they cannot be said to be free. This, of course, is the kind of "cooperation" that exists at the hands of the state.

Western civilization -- like other advanced civilizations -- is the result of "achievements of men who have cooperated according to the pattern of contractual coordination."<sup>5</sup> The contractual state is guided by such concepts as natural rights to life, liberty, and property and government under the rule of law. In contrast, the "hegemonic society" is a society that does not respect natural rights or the rule of law. All that matters are the rules, directives, and regulations issued by dictators, whether they are called "kings" or "congressmen." These directives may change daily, and the wards of the state must obey. As Mises wrote: "The wards have one freedom only: to obey without asking questions."<sup>6</sup>

Trade involves the exchange of property titles. Restrictions on free trade are therefore an attack on private property itself and not "merely" a matter of "trade policy." This is why such great classical liberals as Frederic Bastiat spent many years of their lives defending free trade. Bastiat, as much as anyone, understood that once one acquiesced in protectionism, then no one's property will be safe from myriad other governmental acts of theft. To Bastiat, protectionism and communism were essentially the same philosophy.

It has long been recognized by classical liberals that free trade was the most important means of diminishing the likelihood of war. And nothing is more destructive of human freedom than war. War always leads to a permanent enlargement of the state -- and a reduction in human freedom -- regardless of who wins. On the eve of the French Revolution many philosophers believed that democracy would put an end to war, for wars were thought to be fought merely to aggrandize and enrich the rulers of Europe.

The substitution of representative government for royal despotism was supposed to end warfare once and for all, for the people are not concerned about territorial acquisition through conquest. The French quickly proved this theory wrong, however, for under the leadership of Napoleon they "adopted the most ruthless methods of boundless expansion and annexation . . . ." <sup>(7)</sup>

Thus, it is not democracy that is a safeguard against war but, as the British (classical) Liberals were to recognize, it is free trade. To Richard Cobden and John Bright, the leaders of the British Manchester School, free trade -- both domestically and internationally -- was a necessary prerequisite for the preservation of peace. For in a world of trade and social cooperation, there are no incentives for war and conquest. It is government interference with free trade that is the source of international conflict. Indeed, naval blockades that restrict trade are the ultimate act of war, and have been for centuries. Throughout history, restrictions on trade have proven to be impoverishing and have instigated acts of war motivated by territorial acquisition and plunder as alternatives to peaceful exchange as the means of enhancing living standards.

It is no mere coincidence that the 1999 meeting of the World Trade Organization -- a cabal of bureaucrats, politicians, and lobbyists which favors government-controlled trade -- was marked by a week-long riot, protests, and violence. Whenever trade is politicized the result is inevitably conflict that quite often leads, eventually, to military aggression.

Mises summarized the relationship between free trade and peace most eloquently when he noted:

*What distinguishes man from animals is the insight into the advantages that can be derived from cooperation under the division of labor. Man curbs his innate instinct of aggression in order to cooperate with other human beings. The more he wants to improve his material well-being, the more he must expand the system of the division of labor. Concomitantly he must more and more*

*restrict the sphere in which he resorts to military action. ...Such is the laissez-faire philosophy of Manchester.*<sup>8</sup>

As Frederic Bastiat often said, if goods can't cross borders, armies will. This is a quintessentially American philosophy in that it was the position assumed by George Washington, Thomas Jefferson, and Thomas Paine, among others. A foreign policy based on commerce," wrote Paine in *Common Sense*, would secure for America "the peace and friendship" of the Continent and allow her to "shake hands with the world -- and trade in any market."<sup>9</sup> Paine -- the philosopher of the American Revolution -- believed that free trade would "temper the human mind," help people to "know and understand each other," and have a "civilizing effect" on everyone involved in it.<sup>10</sup> Trade was seen as "a pacific system, operating to unite mankind by rendering nations, as well as individuals, useful to each other. . . . War can never be in the interest of a trading nation."<sup>11</sup>

George Washington obviously agreed. "Harmony, liberal intercourse with all Nations, are recommended by policy, humanity and interest," he stated in his September 19, 1796 Farewell Address.<sup>12</sup> Our commercial policy "should hold an equal and impartial and; neither seeking nor granting exclusive favours or preferences; consulting the natural course of things; diversifying by gentle means the streams of Commerce, but forcing nothing . . ."<sup>13</sup>

### **The Eternal Struggle Between Freedom and Mercantilism**

The period of world history from the middle of the fifteenth to the middle of the eighteenth centuries was an era of growth in world trade and invention and of institutions suited to trade. Technological innovations in shipping, such as the three-masted sail, brought the merchants of Europe to the far reaches of America and Asia. This vast expansion of trade greatly facilitated the worldwide division of labor, greater specialization, and the benefits of comparative advantage.<sup>14</sup>

But whenever human freedom advances, as it did with the growth of trade, state power is threatened.

So states did all they could then, as now, to restrict trade. It is the system of trade restrictions and other governmental interferences with the free market, known as mercantilism, that Adam Smith railed against in *The Wealth of Nations*. As Rothbard has written:

Mercantilism, which reached its height in the Europe of the seventeenth and eighteenth centuries, was a system of statism which employed economic fallacy to build up a structure of imperial state power, as well as special subsidy and monopolistic privilege to individuals or groups favored by the state. Thus, mercantilism held that exports should be encouraged by the government and imports discouraged.<sup>15</sup>

Classical liberals waged an ideological war against mercantilism during the eighteenth and nineteenth centuries, and scored some major victories for freedom. The French "physiocrats," led by Dr. Francois Quesnay, a physician who got interested in economic topics (at a time when "physicians" bled their patients with leeches and "surgery" meant the amputation of limbs). The physiocrats were quite influential from the 1750s to the 1770s and were among the first laissez faire thinkers who contemptuously denigrated mercantilist propaganda and called for complete freedom of domestic and international trade. Their position was based on sound economics as well as Lockean notions of natural rights. Quesnay wrote that "Every man has a natural right to the free exercise of his faculties provided he does not employ them to the injury of himself or others."<sup>16</sup>

When he became Finance Minister of France in 1774, Anne Robert Jacques Turgot, a precursor of the Austrian School, decreed freedom of import and export of grain as his first official act.

At around the same time, Adam Smith was defending trade on moral as well as economic grounds by enunciating his doctrine of how free trade was part of the system of "natural justice." One of the ways he did this was to defend smugglers and the act of smuggling as a means of evading

mercantilist restrictions on trade. The smuggler, explained Smith, was engaged in "productive labor" that served his fellow man (i.e., consumers), whereas if he is caught by the government and prosecuted, his capital is "absorbed either in the revenue of the state or in that of the revenue-officer," which is an "unproductive" use "to the diminution of the general capital of the society. . . ."17

### **The Manchester School**

Despite powerful arguments in favor of free trade offered by Quesnay, Smith, David Ricardo, and others, England (and other countries of Europe) suffered from protectionist trade policies for the first half of the nineteenth century. But this situation was turned around due to the heroic and brilliant efforts of what came to be known as the "Manchester School," led by two British businessmen, John Bright and Richard Cobden. Thanks to Bright and Cobden Great Britain achieved complete free trade by 1850.

The British public was plundered by the mercantilist "corn laws" which placed strict import quotas on the importation of food. The laws benefited political supporters of the government who were engaged in farming at the expense of much higher food prices, which was especially harmful to the poor. Bright and Cobden formed the Anti-Corn Law League in 1839 and turned it into a well-oiled political machine with mass support, distributing literally millions of leaflets, holding conferences and gatherings all around the country, delivering hundreds of speeches, and publishing their own newspaper, *The League*.<sup>18</sup>

The Irish potato famine of 1845 created great pressures for repeal of the Corn Laws, which was finally achieved on June 25, 1846. The elimination of all other import duties followed, and a 70-year period of British free trade began. Richard Cobden was also influential in pushing through the Anglo-French treaty of 1860, which lowered French tariffs and helped put that country on the road to freer trade.

### **The Great Bastiat**

From his home in Mugron, France, Frederic Bastiat

single handedly created a free-trade movement in his own country that eventually spread throughout Europe. Bastiat was a gentleman farmer who had inherited the family estate. He was a voracious reader, and spent many years educating himself in classical liberalism and in just about any other field that he could attain information about. After some twenty years of intense intellectual preparation, articles and books began to pour out of Bastiat (in the 1840s). His book, *Economic Sophisms*, is to this day arguably the best defense of free trade ever published. His second book, *Economic Harmonies*, quickly followed, while Bastiat published magazine and newspapers all over France. His work was so popular and influential that it was immediately translated into English, Spanish, Italian, and German.

Due to Bastiat's enormous influence free-trade associations, modeled after one he had created in France and similar to the one created by his friend, Richard Cobden, in England, began to sprout in Belgium, Italy, Sweden, Prussia, and Germany.

To Bastiat, collectivism in all its forms was immoral as well as economically destructive.

Collectivism constituted "legal plunder," and to argue against the (natural) right to private property would be similar to arguing that theft and slavery were "moral." The protection of private property is the only legitimate function of government, Bastiat wrote, which is why trade restrictions -- and all other mercantilist schemes -- should be condemned. Free trade "is a question of right, of justice, of public order, of property. Because privilege, under whatever form it is manifested, implies the denial or the scorn of property rights." And "the right to property, once weakened in one form, would soon be attacked in a thousand different forms."<sup>19</sup>

### **The Struggle Against Mercantilism in America**

There is no clearer example of how trade restrictions are the enemy of freedom than the American Revolution. In the seventeenth century all European states practiced the policy of mercantilism. England imposed a series of Trade and Navigation Acts on its

colonies in America and elsewhere, which embodied three principles: 1) All trade between England and her colonies must be conducted by English (or English-built) vessels owned and manned by English subjects; 2) All European imports into the colonies must "first be laid on the shores of England" before being sent to the colonies so that extra tariffs could be placed on them; and 3) Certain products from the colonies must be exported to England and England only.

In addition, the colonists were prohibited from trading with Asia because of the East India Company's state-chartered monopoly. There were import duties placed on all colonial imports into England.

After the Seven Years War (known in America as the French-Indian War), England's massive land holdings (Canada, India, North America to the Mississippi, most of the West Indies) became very expensive to administer and police. Consequently, the Trade and Navigation Acts were made even more oppressive, which imposed severe hardships on the American colonists and helped lead to revolution.<sup>20</sup>

After the American Revolution trade restrictions nearly caused the New England states -- which suffered disproportionately from the restrictions -- to secede from the Union. In 1807 Thomas Jefferson was president and England was once again at war with France. England declared that it would "secure her seamen wherever found," which included U.S. ships. After a British warship captured the USS Chesapeake off Hampton Roads, Virginia, Jefferson imposed a trade embargo that made all international commerce illegal. After Jefferson left office his successor, James Madison, imposed an "Enforcement Act" which allowed war-on-drugs style seizure of goods suspected to be destined for export.

This radicalized the New England secessionists, who had been plotting to secede ever since Jefferson was elected, issued a public declaration reminding the nation that "the U.S. Constitution was a Treaty of Alliance and Confederation" and that the central

government was no more than an association of the states. Consequently, "whenever its [i.e., the Constitution's] provisions were violated, or its original principles departed from by a majority of the states or their people, it is no longer and effective instrument, but that any state is at liberty by the spirit of that contract to withdraw itself from the union."<sup>21</sup>

The Massachusetts legislature formally condemned the embargo, demanded its repeal by Congress, and declared that it was "not legally binding." In other words, the Massachusetts legislature "nullified" the law. Madison was forced to end the embargo in March of 1809.

There has always been a collection of men in America who wanted to bring the British mercantilist system here precisely because it was so destructive of freedom. That is, they figured to be the "commanders" of the system and its chief beneficiaries. As John Taylor of Caroline observed, these men "included Hamilton and the Federalists and later, the politicians of the Era of Good Feelings in the 1820s who eventually became Whigs."<sup>22</sup> These men "sought to bring the British system to America, along with its national debt, political corruption, and Court party . . ."<sup>23</sup>

Taylor, a noted Anti-Federalist, was a lifelong critic of mercantilism and laid out his criticisms in his 1822 book, *Tyranny Unmasked*. Like Bastiat, Taylor saw protectionism as an assault on private property that was diametrically opposed to the freedom the American revolutionaries had fought and died for. The tyranny that Taylor sought to "unmask" was the collection of fables and lies that had been devised by mercantilists to promote their system of plunder. If one looks at England's mercantilist policies, Taylor wrote, "No equal mode of enriching the party of government, and impoverishing the party of people, has ever been discovered."<sup>24</sup> He wrote of the "indissoluble conceptions" between both "the freedom of industry and national prosperity" and also "between national distress and protecting duties, bounties, exclusive privileges, and heavy taxation."<sup>25</sup> The former produces national happiness, whereas the latter produces national misery, according to Taylor.

In pointing out the folly of economic autarky Taylor asked:

*Will Alabama want nothing but cotton, should that State select this species of labour for its staple? Can she eat, drink, and ride her cotton? Can she manufacture it into tools, cheese, fish, rum, wine, sugar, and tea? ...Is not Georgia a market for manufacturers, and Rhode-Island a market for cotton, in consequence of the division of labor?<sup>26</sup>*

Many of Taylor's arguments were adopted and expanded upon by the great South Carolinian statesman John C. Calhoun during the struggle over the 1828 "Tariff of Abominations," which a South Carolina political convention voted to nullify. The confrontation between South Carolina, which was very heavily import dependent, as was most of the South, and the federal government over the Tariff of Abominations almost led to the state's secession some thirty years prior to the War for Southern Independence. The federal government backed down and reduced the tariff rate in 1833.

The Northern manufacturers who wanted to impose British-style mercantilism on the U.S. did not give up, however; they formed the American Whig party, which advocated three mercantilist schemes: protectionism, corporate welfare for themselves, and a central bank to pay for it all. From 1832 until 1861 the Whigs, led by Henry Clay and, later, by Abraham Lincoln, fought mightily in the political arena to bring seventeenth-century mercantilism to America.<sup>27</sup>

The Whig party died in 1852, but the Whigs simply began calling themselves Republicans. The tariff was the centerpiece of the Republican party platform of 1860, as it had been when the same collection of Northern economic interests called itself "Whigs" for the previous thirty years.

By 1857 the level of tariffs had been reduced to the lowest level since 1815, according to Frank Taussig in his classic *Tariff History of the United States*.<sup>28</sup> But when the Republicans controlled the White House and the Southern Democrats left the Congress the Republicans did what, as former Whigs, they had

been itching to do for decades: go on a protectionist frenzy. In his First Inaugural Address Lincoln stated that he had no intention to disturb slavery in the Southern states and, even if he did, there would be no constitutional basis for doing so. But when it came to the tariff, he promised a military invasion if tariff revenues were not collected. Unlike Andrew Jackson, he would not back down to the South Carolinian tariff nullifiers.

By 1862 the average tariff rate had crept up to 47.06 percent, the highest level ever, even higher than the 1828 Tariff of Abominations. These high rates lasted for decades after the war.

In the nineteenth century newspapers were formally associated with one political party or another, and many of the Republican party newspapers in 1860 were openly calling for a military invasion of Southern ports to keep the South from adopting free trade, which was written into the Confederate Constitution of 1861. On March 12, 1861, for example, the *New York Post* advocated that the U.S. Navy "abolish all ports of entry" in the South.<sup>29</sup> On April 2, 1861 the *Newark (NJ) Daily Advertiser* warned ominously that Southerners had "apparently taken to their bosoms the liberal and popular doctrine of free trade" and that free trade "must operate to the serious disadvantage of the North" as "commerce will be largely diverted to Southern cities." The "chief instigator" of "the present troubles," South Carolina, has all along been "preparing the way for the adoption of free trade" and must be stopped by "the closing of the ports" by military force.<sup>30</sup>

As mentioned above, by 1860 England itself had moved to complete free trade; France sharply reduced her tariff rates in that very year; and Bastiat's free-trade movement was spreading throughout Europe. Only the Northern United States was clinging steadfastly to seventeenth-century mercantilism.

After the war the Northern manufacturing interests who financed and controlled the Republican party (i.e., the old Whigs) were firmly in control and they "ushered in a long period of high tariffs. With the

tariff of 1897, protection reached an average level of 57 percent.<sup>31</sup> This political plunder continued for about fifty years after the war, at which time international competition forced tariff rates down moderately. By 1913 the average tariff rate in the U.S. had declined to 29 percent.

But the same clique of Northern manufacturers was begging for "protection" and persisted until they got it when Herbert Hoover signed the Smoot-Hawley tariff of 1929, which increased the average tariff rate on over 800 items back up to 59.1 percent.<sup>32</sup> The Smoot-Hawley tariff spawned an international trade war that resulted in about a 50 percent reduction in total exports from the United States between 1929 and 1932.<sup>33</sup> Poverty and misery was the inevitable result. Even worse, the government responded to these problems of its own creation with a massive increase in government intervention, which only produced even more poverty and misery and deprived Americans of more and more of their freedoms.

## CONCLUSIONS

Since the seventeenth century all the great classical liberals have defended free trade and opposed trade restrictions. Trade restrictions are an attack on the institution of private property, interfere with the international division of labor that is the source of our prosperity, and are nothing less than an act of theft. As Murray Rothbard remarked:

*"The impetus for protectionism comes not from preposterous theories, but from the quest for coerced special privilege and restraint of trade at the expense of efficient competitors and consumers. In the host of special interests using the political process to repress and loot the rest of us, the protectionists are among the most venerable. It is high time that we get them, once and for all, off our backs, and treat them with the righteous indignation they so richly deserve."*<sup>34</sup>

1. Murray Rothbard, "Protectionism and the Destruction of Prosperity,"
2. Ludwig von Mises, Human Action: A Treatise on Economics, Scholar's Edition, (Auburn, Ala: Mises Institute, 1998), p. 195.
3. Ibid.

4. Ibid., p. 196.
5. Ibid., p. 198.
6. Ibid., p. 199
8. Ibid., p. 827.
9. Thomas Paine, Common Sense, p. 20, in Philip S. Foner, Complete Writings of Thomas Paine (New York: 1954).
10. Ibid.
11. Ibid.
12. W.B. Allen, editor, George Washington: A Collection (Indianapolis: LibertyClassics, 1988), p. 525.
13. Ibid.
14. Nathan Rosenberg and L.E. Birdzell, Jr., How the West Grew Rich (New York: BasicBooks, 1986), pp. 71-112.
15. Murray Rothbard, "Mercantilism: A Lesson for Our Times?" in his book, *The Logic of Action II* (Cheltenham, UK: Edward Elgar, 1997), p. 43,
16. Cited in Henry Higgs, *The Physiocrats* (New York: Langland Press, 1952), p. 45.
17. Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (New York: Oxford University Press, 1976), p. 898.
18. Nick Elliott, "*John Bright: Voice of Victorian Liberalism*," in Burton W. Folsom, Jr., editor, *The Industrial Revolution and Free Trade* (Irvington, NY: Foundation for Economic Education, 1996), p. 28.
19. Frederic Bastiat, *Selected Essays on Political Economy*, George B. de Huszar, ed. (Irvington, NY: Foundation for Economic Education, 1995), p. 111.
20. Samuel Eliot Morison, Henry Steele Commager, and William Leuchtenburg, *The Growth of the American Republic* (New York: Oxford University Press, 1980), pp. 112-125.
21. James Banner, *To the Hartford Convention: The Federalists and the Origins of Party Politics in Massachusetts, 1789-1815* (New York: Alfred A. Knopf, 1970), p. 301.
22. John Taylor, *Tyranny Unmasked* (Indianapolis: Liberty Fund, 1992), p. xvi.
23. Ibid.
24. Ibid., p. 11.
25. Ibid., p. 19.
26. Ibid., p. 24.
27. Michael F. Holt, *The Rise and Fall of the American Whig Party* (New York: Oxford University Press, 1999)
28. Frank Taussig, *A Tariff History of the United States* (New York: Putnam, 1931), p. 157.
29. Howard Perkins, *Northern Editorials on Secession* (Gloucester, MA: Peter Smith, 1964)p. 600.
30. Ibid., p. 602.
31. Wilson Brown and Jan Hogendorn, *International Economics* (New York: Addison-Wesley, 1994), p. 188.

32. Ibid. p. 192.

33. Ibid., p. 193.

34. Rothbard, "Protectionism."

## The Looming Mortgage Liquidity Crisis

by Doug French

Every 10 years or so there is a banking crisis. We are due. However, the furthest thing from most people's minds with the Trump boom is a banking/financial crisis, except for a few folks at the Brookings Institution, who just released a paper entitled "Liquidity Crisis in the Mortgage Market."

You Suk Kim, of the Federal Reserve Board; Steven M. Laufer, who also labors on the Federal Reserve Board along with Karen Pence, plus, Richard Stanton of the University of California, Berkeley, and Nancy Wallace, also of University of California, Berkeley, to give away the punchline from their paper's abstract, write, "We describe in this paper how nonbank mortgage companies are vulnerable to liquidity pressures in both their loan origination and servicing activities, and we document that this sector in aggregate appears to have minimal resources to bring to bear in a stress scenario."

John and Joan Q. Public believe the 2018 mortgage business is like George Bailey's Building & Loan in "It's a Wonderful Life." People deposit money, bankers lend it out, keeping the mortgage on their books. Easy Peasy.

As the folks from Brookings point out, it's not that easy in these dark days of financial engineering. George Bailey's handshake, promise and maybe a few words on a document to be signed by the borrower which meant simply, "I'll pay you back," has become a financial instrument, to be traded and hypothecated by faceless financial bureaucrats, each one taking a sliver of profit off the top.

Everyone remembers the crash of 2008 and plenty explanations have been posited. What the writers for Brookings explain is,

The literature has been largely silent on the

liquidity vulnerabilities of the short-term loans that funded nonbank mortgage origination in the pre-crisis period, as well as the liquidity pressures that are typical in mortgage servicing when defaults are high. These vulnerabilities in the mortgage market were also not the focus of regulatory attention in the aftermath of the crisis.

They continue,

Of particular importance, these liquidity vulnerabilities are still present in 2018, and arguably the potential for liquidity issues associated with mortgage servicing is even greater than pre-financial crisis. These liquidity issues have become more pressing because the nonbank sector is a larger part of the market than it was pre-crisis, especially for loans securitized in pools with guarantees by Ginnie Mae.

George Bailey and his little financial institution are nowhere to be found.

The authors quote former Ginnie Mae president Ted Tozer concerning the stress between Ginnie Mae and their nonbank counterparties.

... Today almost two thirds of Ginnie Mae guaranteed securities are issued by independent mortgage banks. And independent mortgage bankers are using some of the most sophisticated financial engineering that this industry has ever seen. We are also seeing greater dependence on credit lines, securitization involving multiple players, and more frequent trading of servicing rights and all of these things have created a new and challenging environment for Ginnie Mae. . . . In other words, the risk is a lot higher and business models of our issuers are a lot more complex. Add in sharply higher annual volumes, and these risks are amplified many times over. . . . Also, we have depended on sheer luck. Luck that the economy does not fall into recession and increase mortgage delinquencies. Luck that our independent mortgage bankers remain able to access their lines of credit. And luck that nothing critical falls through the cracks...

Tozer said these words in 2015. The mortgage engine is built for perfection: a thriving economy, with low interest rates, allowing everyone, from the mortgage borrowers to the credit line providers and securitizers to keep their promises.

However, the world is anything but perfect.

Nonbank mortgage providers essentially borrow short and lend long, using warehouse lines of credit from banks to fund mortgages. From 2012 to the third quarter of 2017, commitments on warehouse lines has increased 70 percent. Of course, if all goes well, a mortgage will be sold quickly into the secondary market (on average 15 days) and the line will be reduced.

The Brookings authors identify three vulnerabilities in the process.

- 1) margin calls due to aging risk (i.e., the time it

takes the nonbank to sell the loans to a mortgage investor and repurchase the collateral) and/or mark-to-market devaluations, 2) roll-over risk and 3) covenant violations leading to cancellation of the lines.

These vulnerabilities are very real, should there be a sudden increase in interest rates or other significant change in the market that causes collateral values to drop. Most nonbank lenders have multiple warehouse lines. However, cross default provisions will trigger a scramble amongst warehouse lenders for a mortgage originator's assets should it default on one of its lines.

The authors explain,

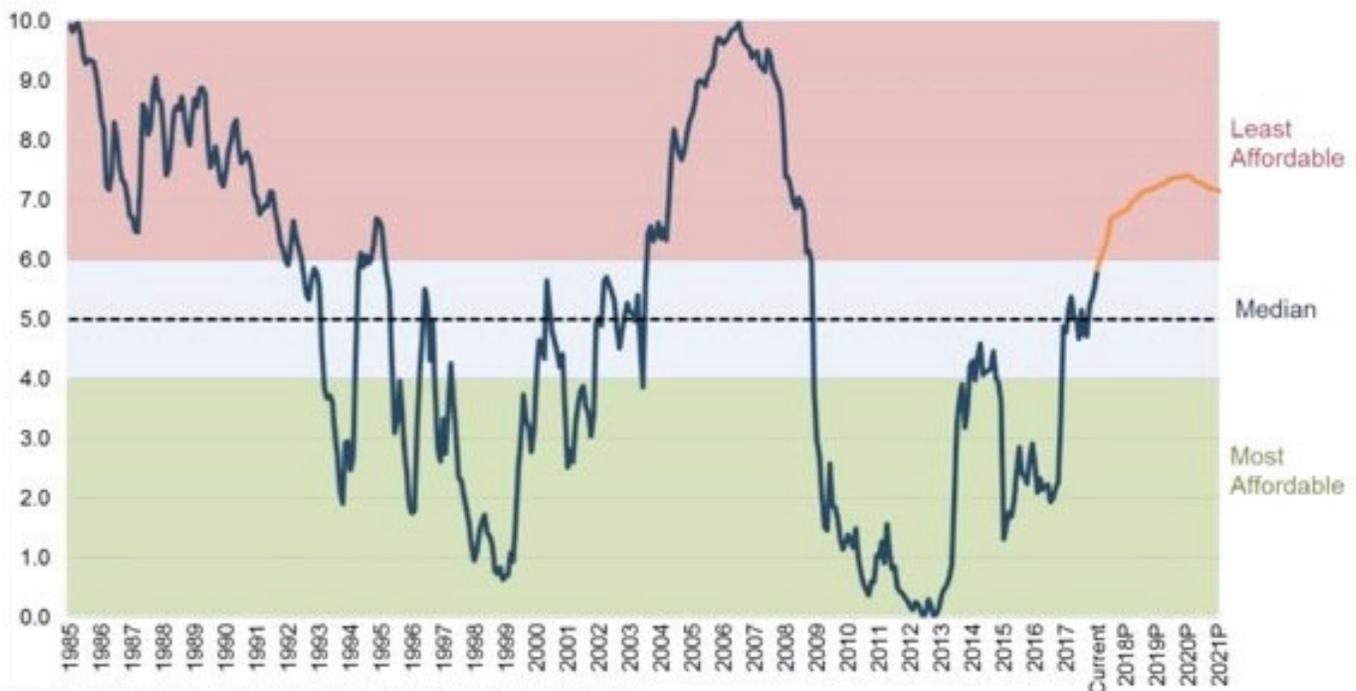
These sources of warehouse credit began to dry up rapidly in the run-up to the financial crisis as the slowdown in the securitization markets made it difficult for the nonbanks to move loan

## Burns Affordability Index

Near its average, affordability is worsening (5.8 on our 0–10 scale). We expect affordability to deteriorate through 2020/2021 as mortgage rates and home prices continue to climb higher.

### Burns Affordability Index™

Index ranges from 0 to 10 based on the relationship between the median household income and the annual housing costs (mortgage plus taxes, insurance, and mortgage insurance for a home equal to 80% of the median-priced home).



Source: John Burns Real Estate Consulting, LLC. (Data: Jan-18 Pub: Feb-18)

originations off the warehouse lines and the premiums paid for subprime warehoused loans evaporated. In 2006:Q4 there were 90 warehouse lenders in the U.S. with about \$200 billion of outstanding committed warehouse lines; however, by 2008:Q2 there were only 40 warehouse lenders with outstanding committed lines of \$20–25 billion, a decline exceeding 85%.<sup>34</sup> By March of 2009, there were only 10 warehouse lenders in the U.S. In addition, runs on SIVs led to the collapse of this form of warehouse funding by the end of 2007 ... and it has not returned as a funding source post-crisis.

Mortgage servicers have liquidity issues because they are required to continue making payments to investors, tax authorities, and insurers if mortgage borrowers quit making payments. Servicers are eventually reimbursed for these “servicing advances,” however, they need to finance the advances in the interim.

For example, servicers were stressed last year when hurricane victims were allowed payment forbearance by Ginnie Mae and the GSEs. Fortunately, the servicers were geographically diversified enough to manage through the strain.

Again, everything is dandy if borrowers make their payments. However, as Mike “Mish” Shedlock explains,

Nonbanks are vulnerable to macroeconomic shocks, rising interest rates, home price declines and job losses, often with a bare minimum down payment.

This is happening while debt-to-income DTI ratios are on the rise (Fannie Mae increased its DTI ceiling from 45 percent to 50 percent last July 29) and median FICO scores are dropping.

This is hardly surprising given homes are not affordable.

The crash clock is ticking.

*Douglas French is former president of the Mises Institute, author of Early Speculative Bubbles & Increases in the Money Supply, and author of Walk*

*Away: The Rise and Fall of the Home-Ownership Myth. He received his master's degree in economics from UNLV, studying under both Professor Murray Rothbard and Professor Hans-Hermann Hoppe.*

## Why Passionate Educators Should Consider Leaving Academia

by Isaac M. Morehouse

Professors and teachers: The best way to increase the quality and engagement of students is to separate your instruction from accredited institutions.

Don't complain about low-quality students; they're not there for you and mostly don't care about your ideas. They're there for a piece of paper they think is a magic ticket to acceptance in the world and they suffer through your class as a cost.

You're too good to deal with students like that who don't value your work!

Step out from behind the subsidized, cartelized, credentialized system and offer your instruction to excited customers in the market!

Ask Thaddeus Russell how much better Renegade U customers are than students in college courses for credit. Ask Austin Batchelor how amazing his tens of thousands of aspiring artist pupils on Udemy are. Ask anyone who's talked at a conference or seminar that didn't offer credit but was filled with people who actually wanted to hear your ideas!

Don't be afraid. There is a massive market for knowledge and good instruction.

If you're good, you're likely to make more money, because you'll reap directly what customers value and won't be subsidizing low quality colleagues or administrators. The upside is limitless.

Of course if you're not good at conveying ideas, you'd better get good or you won't make as much. This is a healthy discipline!

And no, you won't lose “academic freedom”, you'll gain more of it.

The world is so full of opportunity for hard-working

intellectuals to make more money, interact with far better minds, and have more fun if they can muster the imagination and courage to stop chaining their work to the musty halls of accredited paper mills.

The revolution is well underway.

## How the Founder of Dell Convinced His Parents It Was OK to Quit College

by Derek Magill

Michael Dell shared the first ever financial statement from Dell on Twitter today and said that it's "the one I used to convince my parents that it was OK for me to not go back to college." Though we won't all be the next Michael Dell, I think he makes an important point about convincing your parents that it's okay for you to drop out of college.



| STATEMENT OF EARNINGS  |                      |             |
|--|----------------------|-------------|
| DELL COMPUTER CORPORATION<br>400<br>P.O. BOX 1219<br>THREE-MONTH PERIOD ENDED<br>JULY 31, 1984 |                      |             |
|  | AMOUNT               | PERCENT     |
| <b>REVENUE</b>   |                      |             |
| SALES  | \$ 888,821.21        | 100%        |
| RETURNS AND ALLOWANCES   | (16,249.34)          | (2)         |
| <b>TOTAL REVENUE</b>   | <b>\$ 888,821.21</b> | <b>100%</b> |
| <b>COST OF SALES</b>   |                      |             |
| BEGINNING INVENTORY  | \$ 66,203.98         | 7%          |
| PURCHASES  | 1,950.00             | -           |
| HARDWARE   | 769,409.36           | 88          |
| SOFTWARE   | 24,760.23            | 3           |
| PERIPHERALS  | 1,663.80             | 1           |
| FREIGHT-IN   | 4,253.26             | 1           |
| <b>TOTAL AVAILABLE</b>   | <b>\$ 866,350.63</b> | <b>100%</b> |
| ENDING INVENTORY   | \$ (175,902.80)      | (20)        |
| <b>TOTAL COST OF SALES</b>   | <b>\$ 690,453.83</b> | <b>78%</b>  |
| <b>GROSS PROFIT</b>  | <b>\$ 198,367.38</b> | <b>22%</b>  |
| <b>OPERATING EXPENSES</b>  |                      |             |
| SALARIES:  |                      |             |
| OFFICE   | \$ 16,130.40         | 2%          |
| OFFICES  | 5,500.00             | 1           |
| OTHER  | 669.18               | 1           |
| COMMISSIONS  | 1,950.00             | -           |
| ADVERTISING AND PROMOTION  | 24,203.84            | 3           |
| AUTO AND TRUCK   | 385.47               | -           |
| BANK SERVICE CHARGE  | 73.75                | -           |
| CREDIT CARD CHARGES  | 320.08               | -           |
| CASH OVER AND SHORT  | (1.64)               | -           |
| CONTRACT LABOR   | 819.20               | 1           |
| DUES AND SUBSCRIPTIONS   | 165.00               | -           |
| EQUIPMENT RENTAL   | 473.28               | 1           |
| LEGAL AND ACCOUNTING   | 450.00               | 1           |
| MISCELLANEOUS  | 174.13               | -           |
| MILEAGE REIMBURSEMENTS   | 522.14               | 1           |
| DEPRECIATION   | 96.40                | -           |
| OFFICE SUPPLIES  | 1,657.96             | 1           |
| OUTSIDE SERVICES   | 650.00               | -           |
| POSTAGE  | 34.96                | -           |
| RENT   | 4,613.00             | 1           |
| SUPPLIES   | 403.08               | -           |
| PAYROLL TAXES  | 3,942.61             | 1           |
| OTHER TAXES  | 10.00                | -           |
| TELEPHONE  | 1,592.24             | 1           |
| TRAVEL   | 33.81                | -           |
| UTILITIES  | 554.68               | 1           |
| <b>TOTAL OPERATING EXPENSES</b>  | <b>\$ 63,604.63</b>  | <b>7%</b>   |
| <b>EARNINGS FROM OPERATIONS</b>  | <b>\$ 134,762.75</b> | <b>15%</b>  |

The best way to convince them is not to argue with them over why you want to leave, but to show them that you can be successful without a degree. Understand that most parents don't really care about the degree. They want to know that you're safe and they're biased against anything that might take you off the safe path. There's very little you can do to fight that through arguing and that's okay. Don't fight against it, don't argue, just drop out and show that you can satisfy that need without being in college.

One of my favorite quotes from The Fountainhead occurs when Peter Keating asks Howard Roark whether he should start working or take a scholarship to a prestigious art school:

If you want my advice, Peter, you've made a mistake already. By asking me. By asking anyone. Never ask people. Not about your work.

I learned through experience how true this is. My parents were categorically against my leaving college when I first told them of my plans during my freshman year. They told me to just "stick with it." "Don't be a quitter." "Life is easier with a degree," "we'll be very embarrassed," all the usual arguments you hear. And after a year and a half of arguing, debating, and complaining, nothing had changed. They wanted me to finish college even when they knew I hated it.

I eventually decided that their disapproval was less important than the boredom and creeping dread I felt attending lectures I didn't care about taught by teachers who didn't want to be there. I left college and prepared myself for whatever anger they threw my way. And they were mad. They were really mad. My brother had gone to college and done what was expected of him without questioning it. Why couldn't I have done the same?

But then a funny thing happened when I stopped caring what they thought and started focusing on myself and my goals. Their anger went from begrudging acceptance to approval to my biggest fan as soon as I started making money on my own terms. I was getting clients around the country and

traveling. I moved to Austin and took a job at a startup, then realized my marketing business was growing and the opportunities lay with that, so I left. That turned into a full-time role running marketing at another startup and opportunities to speak internationally. My life was great.

And what was previously the worst decision of my life became the best decision I'd ever made. They now like to tell everybody about it. It went from, "My son is...a dropout" to "My son is a dropout!" in about 6 months. I showed them that the kind of life I wanted was possible by going out and living it successfully, and like Michael Dell, I think this was the only way to do it. And this has been the experience that most dropouts I know have had with their parents.

Students who want to drop out of college ask me all the time now what they should tell their parents. The best advice I can give them is not to tell them much of anything. You're taking an unorthodox path and you can't expect them to just take your word that it's going to be okay. Trust yourself to drop out and make the kind of life you want a reality. It's your life, yours alone, and you have to live with the successes and failures. I guarantee, if they're parents worth maintaining a relationship with at all, they will come around to your side when you've built it.

Reprinted from the author's blog.

Derek Magill is a college dropout, marketer, business strategist and career expert. He is currently the Director of Marketing at Praxis and has consulted with companies such as Voice & Exit, the Foundation for Economic Education, Glockstore, Colliers International, Daily Caller, and Undertech.

Derek is the author of *How to Get Any Job You Want*.

This article was originally published on FEE.org.

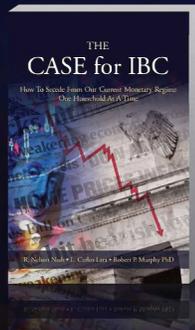
**Welcome IBC Practitioners**  
<https://www.infinitebanking.org/finder/>

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

- Brian Fleming - Milwaukee, Wisconsin
- Dwayne Burnell - Bothell, Washington
- Timothy Bogert - Rochester, Michigan
- Tommy Ruff - Harrison, Arkansas
- Arael Christall - Santa Fe, New Mexico
- Kyle Davis - Orlando, Florida

*You can view the entire practitioner listing on our website using the Practitioner Finder.*

IBC Practitioner's have completed the IBC Practitioner's Program and have passed the program exam to ensure that they possess a solid foundation in the theory and implementation of IBC, as well as an understanding of Austrian economics and its unique insights into our monetary and banking institutions. The IBC Practitioner has a broad base of knowledge to ensure a minimal level of competency in all of the areas a financial professional needs, in order to adequately discuss IBC with his or her clients.

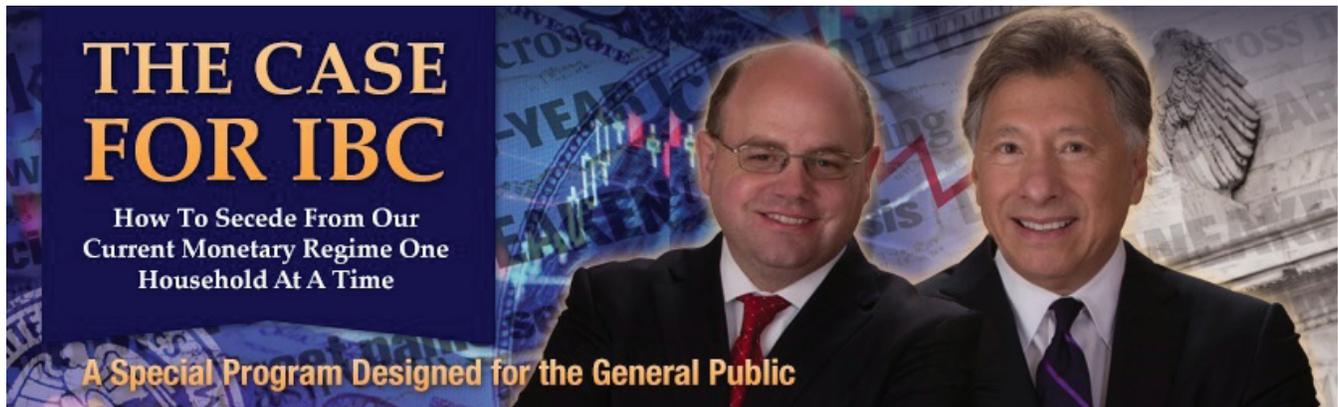


Something is  
**FUNDAMENTALLY WRONG**  
with our financial system.

R. Nelson Nash's Infinite Banking Concept (IBC) is a revolutionary method to take the banking function away from the "experts" and return it to the individual household and business owner.

In *The Case for IBC*, Nash is joined by business consultant L. Carlos Lara and economist Robert P. Murphy to provide the most succinct explanation to date of why IBC works.

Order The Case for IBC Now



**The next IBC Seminar is scheduled for 19 May, 2018 in Chicago.**

**[click here for registration information](#)**

*You've known for years that something is wrong with our financial system. But you could never quite put your finger on it... we tried leaving the financial "experts" in charge... but what can the average person do?*

The Nelson Nash Institute created a training program for financial professionals, then we took the show on the road, bringing our message to the general public.

Come learn IBC from the authors of the book linking IBC with Austrian economics.

*A financial education seminar...that's a crash course in the Infinite Banking Concept*

Whether running a household or a business, do you feel your money is in safe hands? Would you like another option? You must make the first step. But you'll need a coach along the way.

**The Seminar is a four-hour live event designed for the general public.**

R. Nelson Nash, the creator of the *Infinite Banking Concept*, and best-selling author of the classic *Becoming Your Own Banker* is not conducting his seminars anymore. Nelson helped develop the *New IBC Seminar* featuring Dr. Robert P. Murphy, L. Carlos Lara and David Stearns. David is the President of IBC LLC; Robert P. Murphy, Ph.D economist, and L. Carlos Lara, are the authors of the book *How Privatized Banking Really Works*, and co-authored with Nelson, the new book *The Case For IBC*.

**Saturday, May 19, 2018 from 10:00 AM to 3:00 PM CDT**

**Hyatt Lodge At McDonald's Campus**

**2815 Jorie Boulevard**

**Oak Brook, IL 60523**

**[click here for registration information](#)**