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Bank Deposits Are Risky - Now More Than Ever

by L. Carlos Lara

Very few Americans have paid enough close attention to the particulars of a law that began to be formulated shortly after the financial crisis of 2008 and was ratified January 21, 2010. This lack of awareness on the part of the public is certainly understandable. First of all you don’t see much of it in the news and, secondly, who would want to take the time to read it or struggle trying to understand it? The document itself is nearly one thousand pages long and some estimate that by the time the IRS and other government regulators get done with it, the final document could be thirty times larger. In other words, it’s a long way from being completed. It has 243 rules, calls for 67 studies, 22 periodic reports and has created three new government oversight agencies with the SEC, the Federal Reserve and the FDIC having expanded powers. It is the most sweeping overhaul of the financial markets since the Great Depression. Even the Volker Rule provisions, named after a former Federal Reserve Chairman, were reinstated (subject to limited exceptions) into the law by a Senate bill. This prohibits U.S. banks from most proprietary trading including owning, sponsoring or investing in hedge funds. The overall intent of this massive enactment is to provide increased preventive regulation in order to strengthen the financial markets in case of another crisis. Additionally, it provides for an expedient liquidation process for any insolvent financial institution, including the regulatory tools to implement the liquidation. More specifically, it is aimed to increase Wall Street transparency and investor protection as a means of bolstering investor confidence to draw them back to the capital markets.

Yet, one cannot help to conclude that there really must be a giant crash out there somewhere in the horizon, for even our own government officials, who were caught completely off-guard when the last one occurred, have definitely gone into a state of preparedness with the passing of the Dodd-Frank Wall Street Reform and Consumer Protection Act.¹

From Bailouts To Bail-Ins

The parts of this document that have raised the most eyebrows by those that have actually looked into it are the sections that indicate that “too-big-to-fail” institutions will not be bailed out by taxpayer dollars this next time around. Instead they will be shored up by making use of “contingent capital” and in certain critical situations “bail-in” capital pooled together from the failed institution’s own stockholders and creditors. This part in particular has good news and bad news implications, depending on how you see the economic world. But think what you will, this new strategy is actually prudent on the part of our officials. If there is one thing that the general public did finally understand, even though it may have taken them three years to make full sense of it, is that they were royally hammered by the previous bailouts. If Congress, or the President, attempt to use taxpayer bailouts again there will no doubt be a thundering outcry in the streets.

Today there are also three critical masses or bubbles
we did not have six years ago and our officials know this all too well. Any of these could actually blow, if not at the same time, then certainly one at a time in falling dominoes fashion. These are the U.S. dollar, U.S. Treasuries, and the stock market. Plus, we are now so interconnected to the rest of the financial world and play such a central role in that theatre that the global ramifications when another crisis occurs will be astronomical. Regardless of these comprehensive and far-reaching preventive measures to deal with our world dilemma there are still certain significant problems within our economy, money, and banking systems that contain dire consequences for us as individuals that this new law can only serve to magnify. This article is directed at pointing to several of the most critical issues with a recommendation that they should be taken seriously and to offer a few suggestions of what one can do to steer around them.

**What Is Bail-In Capital?**

Since contingent capital is given so much of the limelight for being able to provide the preventive measures to mitigate systemic risk, one of the first questions to answer is “What exactly is contingent capital?” Basically, they are hybrid securities that are issued by financial institutions intended to provide a safeguard or shield under critical scenarios when it is difficult for the institution to raise capital. They are, however, nothing new. Rating agencies view contingent capital securities favorably because of their loss-absorbing features. The insurance industry has used them for decades, which should not surprise any of us due to the conservative nature of this sector. But utilizing them in an industry like banking where liquidity crises are endemic is different, especially with the new caveats that are being required. Among other things, these new regulatory directives emphasize increasing the quality of the capital base in financial institutions in order to help banks remain a going concern at the time of crisis, as opposed to filing for bankruptcy. These capital threshold requirements are spelled out in detail in the International Reforms known as Basel III formulated by the European Union, if anyone is interested in digging deeper. In fact, the European Union has already passed its initial phase into law as of January 2013 and the completed framework is to be fully phased in by 2018. Though the Dodd-Frank Act has not officially mandated the exact requirements of Basel III to be incorporated for the U.S. as of this date, the intention is to mirror the quality of its capital thresholds.

In essence, contingent capital instruments’ most important characteristic is that they are generally debt securities with conversion to equity features in the event of certain capital threshold triggers. The triggers are the points when the conversion mechanism is activated. These conversion features represent a form of shock absorber by creating immediate liquidity within the issuer’s capital structure at the time of conversion. There are also regulatory triggers that cause actions by the regulatory authorities to be taken against the issuer at critical financial decline stages. With this latter trigger the possibility of a write-down of principal up to 100% can also occur.

*Bail-in* capital, also referred to as “statutory bail-in,” is a completely different strategy. This step is utilized after the contingent capital securities have been converted to equity or the write down of principal occurs and such actions have not resulted in providing sufficient liquidity to keep the institution from going into insolvency. Under these circumstances, the authorities take over to create creditor claims made up from the stockholders and unsecured creditors of the institution. These claims are then written down or converted into equity in order to save the institution. However, under the Dodd-Frank Act, federal authorities will have a more expansive role in using statutory bail-ins and will be able to place large bank holding companies (BHCs) and significant nonbank holding companies in receivership under federal control with the FDIC acting as the receiver. These so-called “covered companies” make up a significant part of our entire financial markets in the U.S. and include some abroad as well. According to the American Bankers Association these companies’ stockholders, creditors, vendors, etc., will have no assurance in advance as to whether critical financial circumstances will be dealt with in Chapter 11 Bankruptcy, Chapter 7 liquidation, or federal receivership under Title II of
the Act.

“The goal of a receivership under Title II of the Act is to provide the authority to liquidate failing companies that pose a significant risk to the financial stability of the U.S. in a manner that mitigates such risk and minimizes moral hazard. The authority provided in Title II of the Act is to be exercised in a manner that best fulfills that purpose, so that creditors and shareholders will bear the losses of the financial company.”

American Bankers Association on Title 2 Orderly Liquidation Authority
The Dodd-Frank Act

Legally, Bank Customer Deposits Are Loans

One of the first red flags this author wishes to raise is to simply remind the reader that our current legal framework treats commercial bank deposits as loans to that institution. Every time a bank depositor sends a deposit via the tube at the drive through window of the commercial bank, the legal title to his or her money changes immediately. The bank depositor upon making the deposit has just become a creditor of the bank. And, according to the law, the commercial bank depositor is viewed as an unsecured creditor above certain dollar limits. Most Americans do not know this. They innocently assume they are simply having the bank temporarily hold their money for safekeeping to be withdrawn a short time later and although this process works in this manner most of the time, it doesn’t change the law. Under the classic case of Foley vs. Hill (1848) the ruling is that the banker owes the money to the depositor as a debtor and this has been the foundational banking law in the U.S. ever since. In light of the Dodd-Frank Act and the strategies to be used to save troubled banks we need to think twice about those bank deposits in the economic environment of our day.

The Events In Cyprus Are Worth Remembering

In March of last year (2013) Cyprus citizens woke up one weekend morning to make their normal withdrawals from their ATMs only to discover that their money had been frozen. This astonishing realization happened to thousands of depositors of the two largest banks in Cyprus, The Bank of Cyprus and Laiki Bank. When depositors went to their branch bank to determine the cause of the problem they discovered the bank was closed. To their dismay the bank remained closed for twelve days as banking officials and the Cyprus government negotiated the outcome for all of the money belonging to the shareholders and depositors of these banks.

In like manner to the bail-in capital strategy as outlined by the EU Basel III framework, as well as the Dodd-Frank Act, all shareholders of the bank and its unsecured creditors were given equity in a failed entity and/or a write-down on their principle balances. Only depositors with less than €100,000 on deposit were made whole. Businesses were hurt the worst since they generally tend to keep more money in the bank for cash flow purposes than individuals. These businesses were unable to access their money to meet payroll, pay expenses and suppliers causing many to go under, crushing the Cyprus economy. In a recent Reuters news release dated April 30, 2014 the Bank of Cyprus was currently, a year later, in the process of releasing deposits still frozen under the recapitalization. Nevertheless, losses to shareholders and creditors of the banks have been reported to have reached 60% with some unsecured creditors receiving nothing.

Some commentators have pointed to what happened in Cyprus as the test for a bail-in strategy to mitigate systemic risk in the midst of a financial crisis. The results thus far have proven to be positive in certain banking and government circles by emphasizing that minimal tax-payer bailout money was required and only one bank was lost.

What Will Trigger The Next Financial Crisis?

There are several crucial elements that could trigger the next financial meltdown. It is hard to know for sure what will set it off, but it will most likely be the same trigger as the last one—the derivatives market. Derivatives are extremely high-risk investment instruments claimed to be “collateralized” because in bankruptcy they have been given super priority
status over stock-holders and creditors. Bankruptcy\(^a\), however, is a state of dwindling assets so we must keep this preferential status in perspective. For example, according to the Bank of International Settlements, (the central bank for all central banks) says that the notional value of derivative contracts worldwide is $700 trillion. In the United States alone the notional value of derivatives according to the Office of the Controller of the Currency (OCC) is $240 trillion. But the total worldwide GDP is estimated at only $75 trillion! Even though these are vague concepts the disparity between these numbers is enormous. The almost ten-to-one ratio of derivatives exposures to annual income shows just how leveraged our financial markets are, and how vulnerable they will be in the event of another crash.

**What About The FDIC?**

We rely on the FDIC guarantee far too heavily. Of course we all know that our deposits in banks are protected for amounts under $250,000, but we should never forget that things change dramatically in a financial crisis, now more so since the passing of the Dodd-Frank Act. In reality the FDIC is funded by the premiums paid by banks and thrifts for this insurance coverage, but it’s a mere fraction of coverage and will always remain a fraction in terms of the total scope and size of bank deposits. Recall that in 2009 during the midst of the last crisis there were over 1,200 banks that were underwater and the FDIC went $8 billion in the hole! Now it is certainly true that the FDIC has a line of credit with the Treasury Department, but here we are again, relying on the taxpayer to bailout the banks. This the one thing the Dodd-Frank Act is trying to eliminate, and in so doing, would force the stockholders and creditors of the failed bank to take the direct hit in order to ultimately save the banking system. We should not be surprised if that ultimately means the abandonment of the $250,000 guaranteed threshold. Perhaps the following stats will make my point even clearer. The current total funds in the FDIC coffers stands at $47.2 billion, but the total deposits in U.S. banks is $10.1 trillion! This means that the FDIC can actually cover only ¼ of 1% of the total of U.S. bank deposits. In a major crisis this could become a painful problem for millions of us.

**What Can We Do?**

In light of the evidence it’s easy to become depressed about the entire situation, but we must try not to succumb to it. Instead we should stay on top of these critical issues by staying informed. Here at the LMR we make every effort possible to filter through all the noise and give you the real story from an Austrian perspective in order to guide your thinking. Read it often and, if you are a financial professional, have your clients read it. This study will prevent the deception of the misleading statistics often communicated by mainstream economists and government officials who so often trick people into making grievous financial mistakes. Recognize that a financial reversal can hit an individual very hard and it may take years to recover and in some cases there is no recovery. Regardless of what you see and hear, the economy is still very sick and is being propped up by artificial stimulus. This will invariably lead to more financial trouble. There is no real pool of savings in the U.S. to bring about true recovery because the system is totally against savings. They want everyone to become a speculator. If you must invest, and sometimes we all have to, be careful where and how you invest. So the first recommendation is to stay watchful and conservative.

Secondly, we are definitely in an environment where the whole house could potentially come down. That’s the unfortunate situation. To deal with this kind of problem we need *emergency money*. We need just enough gold or silver to get us through a few months if all hell breaks loose. Even if you buy it in the form of jewelry as gifts for your spouse that can be later melted down, get some gold or silver. In a severe crash it will rise dramatically in price and may serve to dig you out of a deep financial hole when you most need it.

Yet in the interim, Americans all need to use dollar-denominated assets, because that is still the underpinning of the economy. For those who have not been introduced to Nelson Nash’s *Infinite Banking Concept* (IBC), I strongly urge you to get in touch with an Authorized IBC Practitioner to review your
household or business financial situation. You can find an Authorized IBC Practitioner of your choosing here: https://www.infinitebanking.org/finder/ The drawback to owning just gold or silver is that you can't easily spend it (i.e. it is relatively illiquid), so it has to remain in the category of emergency money for when the emergency actually arises. But with an IBC policy we get the savings, the protection, and the access to our money we need in spite of our perilous economic environment. Mutual Life Insurance companies who sell the IBC-structured policy are renowned for conservatism as far back as the Great Depression. In comparison to Wall Street and the commercial banking system, they held firm and protected their policyholders, not with bailout money from the Fed or the government, but by the market. So, keep very few dollars in commercial banks and sweep all excess dollars into your IBC policy. The fact that depositors are now targeted to become the source of bailout money to prop up a failed bank is reason enough to act now on this last suggestion for your own personal safety and that of your household or business.

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References


There Is No Such Thing As A Do-Good State

By Michael S. Rozef April 25, 2014

If enough people contribute voluntarily to the cause of food stamps, then there is no rationale for the U.S. government to force unwilling persons to pay for its program. On the other hand, if not enough people are willing to contribute voluntarily, then why should the U.S. government force unwilling people to pay for it?

The answer we will get is that feeding people is a good cause, just as sending soldiers and jets to Poland is a good cause in the eyes of many. And if people are unwilling to support these good causes, then the argument goes that the government must force them to support them. This is an argument in support of a do-good state.

The immediate objection to the do-good state is that
it is not universalizable. There are all sorts of good causes, and they vary with the persons who regard them as good. The state can’t adopt all of these causes. It cannot even decide which ones are better than others. The state certainly cannot force all those causes it decides are good upon everyone without undermining the life, liberty and pursuit of happiness of its citizens. Let us lay aside this objection, because in the real world we know that governments do adopt a menu of causes that they claim are good causes. They may be acting inconsistently, irrationally, partially and destructively but the idea of the do-good state still has a strong hold on many people.

According to the do-good state argument, one of the state’s purposes is to find good causes that people will not voluntarily support and then to force them to pay for these causes. This purpose is never stated as baldly as this, but it is an accurate characterization. The argument presumes that each person doesn’t know enough to find out or support what that person conceives to be good, but those people who operate the state do have this knowledge. It presumes that persons left to make their own decisions will make inferior or wrong decisions, so that their decision-making capabilities must be abridged by the superior state. In this view, the state is a do-gooder, like a parent that makes children do various things for their own good. In this concept of the paternal state, those who operate the state, its officials and lawmakers, decide what is good. They decide how much to take from citizens to accomplish the good and they decide how to distribute the takings among a menu of causes that they think are good causes.

I think that the preceding is a fair statement of some of the presumptions that underlie the do-good state. I’d go further, however. In the do-good idea of the state, there are superior human beings who run the state and there are inferior human beings who do what these superior beings tell them to do. It is a master-slave relationship that, in this view, is justified by the good that it accomplishes, that good being always what the superior beings see it as and say it is.

I will argue that there is, in reality, no such thing as a do-good state. I will argue that the state’s monopoly power conflicts with and precludes its being a do-good state as any kind of general outcome.

However, the masters of the state do not see it this way. They justify their positions by telling the slaves that they are often or even always listening to them and heeding their collective or majority wishes and that they can always choose different masters as long as they leave untouched the powers of this select group. The slaves are told to be satisfied because they have democracy and they are the real masters. But if it were really true that the masters obeyed the wishes of the slaves, this would mean that the slaves in fact can identify good causes for themselves. Who needs the masters then? And if it’s really true that the collective or majority determines what the government decides is good and uses its power to implement, then this only means that the actual masters consist of an unidentifiable and shifting group of voters. One may be a slave with respect to one cause and a master with respect to another. Just because one’s masters are a more diffuse and hard-to-identify group than if they were all sitting on Capitol Hill doesn’t mitigate one’s status of being a slave. These democratic rationales peddled by the masters and by professors of political science do not take the sting out of being a slave.

In practice, most states nowadays are not completely totalitarian. This is not because they don’t want to be totalitarian. They do want complete control, as is shown by many proposed laws. However, they don’t pass certain laws because they’d face too much resistance from the citizens. Before increasing their control, they need to prepare the citizens for it. This is why they do not immediately presume to remove all decision rights from their citizens. They let them choose many actions themselves, such as food, clothing, location, recreation, mates, sex partners, etc. Still, behind the scenes, they use power to alter the menus and to influence choices. Most states are partially totalitarian, and this still gives them plenty of current power over major areas of human decision-making, including law-making, administration of justice, health, education, welfare, the military, agriculture, energy, communications, transportation, commerce, industry, the workplace, one’s associations, and so on.
Individual decision rights are replaced by collective decision rights, which actually means decision rights of those who run the state. All of this existing control gives the state the leverage to increase the degree of totalitarian control. It might conceivably awaken enough consciousness and resistance among the citizens that they alter the balance of power.

All can agree, be they those who support the state as a do-gooder organization or those who think the state embodies a master-slave relationship, that the state claims a monopoly power over citizens; that the state seeks to maintain this power and to impose it on citizens; and that the state has a high degree of success in achieving this objective. In a word, all can agree that the state is POWER, and it seeks to be the final and legitimate word on power in its domain.

In view of human nature and human failings and the monopoly character of the state’s power, which even its supporters do not deny, can the concept of the state as a do-gooder state be valid? No, it can’t possibly be valid. Even if power is considered very narrowly, problems emerge. Defense is one such narrow area. The proper use of power for defensive purposes to enforce rights is not something for which there is clarity or agreement among all human beings. Details of cases vary. Ideas vary about what is right and wrong. Definitions of aggression vary. Ideas of remedies vary. Even if a state is restricted to matters of crime, wrongdoings and justice, its having a monopoly power is questionable. The power to settle issues with finality is one value that the state brings to the table, but the actual content of justice is another value that is very important. When the state has the monopoly power over justice, the content of justice can easily be sacrificed to the finality. This occurs because with power justices can make decisions based on their idiosyncratic ideas. They can also make decisions that cater to private interests and factions and not to justice. Will they do so? What’s to restrain them? Many government courts have very weak institutional mechanisms of restraint. In such circumstances, justice is unlikely to conform even to the do-good ideas that the proponents of the do-good state support. Even if the doing of good by the state is limited to the provision of justice, the monopoly power aspect of the state conflicts with providing justice.

The conflicts between doing good and monopoly power rise rapidly when the state curtails the decision rights of its citizens in all those many broader matters relating to their associations with others (or their exchanges with one another) and absorbs them as its own. It is human nature to seek to use the state’s powers for one’s own ends and devices. It is human nature for those who operate the state to seek to extend its powers. These forces cause the state’s actions to deviate from the many and varied conceptions of what a do-good state should be doing.

It is a pervasive human limitation to be operating with partial knowledge and uncertainty. Every presumption of the do-gooder state is questionable, even if monopoly power were not the important issue that it is. The do-gooders in general have no special insight that enables them to identify the good better than their millions and millions of individual subjects can. The do-gooder rulers are influenced by their own tastes, their own limited knowledge of history, their own ideas of right and wrong, their own ideas of good and bad, their own ambitions, their colleagues, their emotions, not to mention the interest groups that lobby them.

What is clear about the state, to everyone, is that the state is power. What is not clear among those who fancy the do-good state is that this power does not imply that it can be used systematically to do good or will be used systematically to do good. The opposite is more apt to be the case. As a rule, the state’s power can’t be and won’t be used to do good. As a rule, the masters who run the state won’t be able to identify the good of their subjects, that good being highly individual and varying from person to person. By removing decision rights from the citizens, they will impede economic calculation, prevent adaptation to changing prices and conditions, and undermine learning. Complex processes will be replaced by the simplistic decisions of the state’s operatives. Their prioritization of the many conflicting possibilities will not be resolved and cannot be resolved by reference
to the good of the subjects. They will use political and personal calculations. Consequently, the state can not and will not do the good that the do-good state is conceived of as doing by its proponents. Instead, as a rule, it will be a do-bad state.

There is no such thing as an exceptional state, one whose rulers avoid the personal failings of all human beings, who consistently identify what is good and right, and who are capable of bringing it about. The state’s monopoly power has to result in their being selected and operating otherwise than as people who can or will do good. The state’s monopoly power conditions the outcome, which is the state’s being a do-bad state, not a do-good state.

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Comment by R. Nelson Nash – Mike is one my very favorite authors. I look forward to meeting him someday just to chat and listen to him. He sounds just like my mentor, Leonard E. Read. I’m sure the two of them knew each other. Go back to the August 2013 issue of BankNotes on our website and read Mike’s “Don’t Go Back to the Original Constitution”. It explains a lot.

Do We Need a Lender of Last Resort?

by Nicolás Cachanosky Mises Daily: October 20, 2014

Scotland’s vote for independence resulted in a negative. There won’t be, for now, Do further discussions about what Scotland should do with its monetary institutions. Still, there is one more issue that I would like to discuss, because it transcends the particular case of Scotland, had independence been the result of the vote.

There is a widespread belief that a sound banking system requires a central bank to act as a lender of last resort. In a nutshell, the argument goes as follows: there are inherent potential instabilities in the banking system, to avoid a serious crisis and to interrupt means of payment, a central bank that is “external” to market forces should behave as a lender of last resort.

There are two problems with this line of reasoning. First, it takes as given that the banking system is inherently unstable. This is not as obvious as it is sometimes believed. Second, it is assumed that to have a lender of “last resort,” means having a central bank.

Let us say that Scotland voted for independence and unilaterally decided to keep using the British pound (note that a unilateral decision gives the country more flexibility than a bilateral agreement to change the currency if the British pound proved to be a bad choice). In the case of such a unilateral choice, in principle, Scottish banks won’t be able to turn to the Bank of England as a lender of last resort. But this doesn’t mean that the banks fall short on lenders to go to. In fact, they have the financial markets of the whole world to find lenders willing to extend them credit.

It is not, then, that banks don’t have access to lenders absent a central bank. The issue is whether the “lender of last resort” should extend credit to banks under any circumstances or only to banks that are illiquid but solvent. If the central bank, as a lender of last resort, is just going to mimic the market, what’s the point of having one? And if the central bank is not going to behave like the market, namely, easily extend credit to insolvent banks, then it does not only add moral hazard problems to the banking market, but it also fails to add efficiency to the market. A financial market with insolvent banks that are able to subsist thanks to the lender of last resort is less efficient and stable than a market where insolvent banks need to become solvent or discontinue business (like in any other market).

Banking Crises Reward Efficient Banks

The crisis of 1890 in free-banking Australia is telling.
BANKNOTES - Nelson Nash’s Monthly Newsletter - November 2014

While insolvent banks were having problems and losing reserves, more efficient banks were increasing their reserves rather than losing them, contrary to what one would expect from the “inherently unstable” argument. The market share was shifting from inefficient to efficient banks. The banking system wasn’t unstable. It was, in fact, government interference introduced to “control” the crisis that made things worse. A mandatory banking holiday blurred the difference between solvent and insolvent banks; the market did not have a clear signal of which banks should and should not be trusted. Also, the government intervention allowed bankrupt banks to re-open for business without having to pay their old debts. Those banks that managed their reserves and deposits efficiently were now in a worse situation than the banks that got a free pass to ignore their financial obligations. Efficient banks started to lose reserves in favor of formerly inefficient banks now free of their debts.

Another historical case is the Ayr Bank during the Scottish free banking period. The Ayr Bank did what it was not supposed to do: it over-issued convertible banknotes. Not surprisingly, the bank failed. This case is sometimes mentioned as an example of how a bank failure can drag other banks down because Ayr Bank’s bankruptcy negatively affected many small banks. This, however, was limited in its extent because the banks that failed were those investing and exposing themselves to the Ayr Bank. That is, the banks that failed were the Ayr Bank itself, which did not manage its reserves efficiently, and those banks that imprudently invested in Ayr Bank.

Freedom and Flexibility Are the Answer

Other free banks that knew better were not affected by the crisis, and the crisis provides just another historical example of the market working in the money and banking market where market actors are able to separate between efficient and inefficient banks. Moreover, as is common in the banking sector, the accounts of a failing bank can be acquired by banks in good standing, which means that a bank failure does not necessarily imply that their customers lose their deposits. Just as the bankruptcy of a firm is not a market failure, but a market correction, the same interpretation should apply when inefficient banks fail, increasing the market share of efficient banks (like in any other market).

Scotland, had it voted for independence, was highly unlikely to opt for free banking. An alternative for Scotland (or any other newly-independent country) might be to use the Euro (or any other currency) rather than the British pound. Which currency would be best, however, would be up to the local population to decide, and which currency is most advantageous is best discovered through market processes.

The need of a lender of last resort is not a strong argument for having a central bank. It might, actually, be an argument against having a central bank.

Note: The views expressed in Daily Articles on Mises.org are not necessarily those of the Mises Institute.

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Comment by R. Nelson Nash – Nah! We don’t need a lender of last resort. All it has done has just feathered the nest of the bankers and punished the poor.

The Many Ways the State Taxes the Poor

by Julian Adorney

Mises Daily: Monday, October 27, 2014

Most defenders of the state assume that government services help the poor. And, sometimes, some poor people do benefit financially from government programs. But there’s a hidden cost: taxation and mandatory programs (Social Security, for instance) that hurt the needy by restricting their choices. Government taxes away income that low-income households could invest in improving their lives. At the same time, state-sponsored benefits create incentives that keep the poor trapped in poverty.

Many assume that government barely taxes the poor, but the reality is otherwise. The poorest fifth of
Americans pay 16 percent of their incomes in taxes (including federal, state, and local). One in six dollars they earn goes straight to the government. For a family living at the margin, those taxes can be the difference between food on the table and hungry children.

Admittedly, a big chunk of government expenses is for programs designed to help the poor. But even when this money actually helps — and it rarely does — it’s important to note the pernicious effects of taxation. Consider: every dollar of taxes is one dollar that a worker must give to the government first, regardless of whether that dollar could help him feed his family or improve his livelihood. If a poor man is faced with the choice of paying taxes or starting a business, he had best choose the former, otherwise he’ll go to jail.

This is true for the wealthy as well. But poor people live closer to the margin. More of their money is taken up with fixed bills like rent and food. This leaves them less discretionary income to, for instance, invest in a business. Because their pool of discretionary income is smaller, taxes cut deeper into it.

Mandatory government programs, such as Social Security and Medicare, compound the choice-restricting effects of taxation. Social Security, for instance, forces people to save for retirement regardless of whether or not that money could be better spent in another way.

Saving for retirement is generally a good idea; most people anticipate needing a monetary cushion to see them through their golden years. But it’s not the best approach for everyone. The young woman with terminal cancer, for instance, probably won’t be around to enjoy the fruits of Social Security. She can best maximize her happiness by spending that money now, whether it’s on fun experiences, or on taking care of her children, or on better medical treatment. Similarly, for the destitute man who can afford to either save for retirement or feed his children, it takes a heartless bureaucrat indeed to force him to do the former. Yet that is precisely what Social Security does.

Many poor people eventually want to start a business or learn new skills. Both take start-up capital. Imagine that John, a retail worker barely making ends meet, wants to learn to code so that he can find a better job. Most learn-to-code programs, such as Code School, aren’t free. Investing in such a program could significantly increase John’s value and salary, allowing him to improve his finances both now and later. But faced between paying 7 percent of his paycheck to Social Security, or investing that 7 percent in learning new skills to build a career, John has to choose the former or go to jail.

Each individual has his or her unique circumstances. For some, saving for retirement right now might be smart. For others, that money could be better spent on something else. By mandating retirement savings, government robs individuals of the freedom to make their own decisions.

I’ve focused on Social Security, but other government programs have the same effect. Obamacare requires that people buy insurance or pay a fine, even if insurance isn’t in their best interests. Medicare forces the poor to put aside part of their money today to pay for their health care costs in old age — regardless of whether or not that decision is best for the man or woman in question.

But what about programs that give the poor money, like the Supplemental Nutrition Assistance Program and unemployment benefits? Even these programs create perverse incentives, trapping men and women who use them in poverty.

Because government assistance has built-in cutoff points, it creates de facto high marginal tax rates for the poor. If Jane makes $10,000 per year at McDonald’s, she might rely on programs like Medicare and welfare to make ends meet. But imagine she has the option to switch industries and take an entry-level job in a new career (for example, marketing) that pays $25,000 per year. If she takes the new job, she could end up bringing in $2,540 less on net. She might get $15,000 more from her employer, but she’ll lose $17,540 through a combination of higher taxes and reduced government benefits.

For Jane, the economically rational decision is to keep flipping burgers and not move to a new position. Government incentives reward her for staying in a
dead-end job. By obeying these incentives, she misses out on all the promise inherent in a real career. People in marketing tend to be in demand in almost every company, and have more choice in where they want to work. They can earn promotions and climb the corporate ladder. These options aren’t available for a fast-food worker. Government programs give Jane the financial incentive to stay in her current position, restricting her long-term options.

Government programs, well-meaning or not, serve to trap the already downtrodden. By contrast, the market creates freedom and options and promotes upward mobility.

Note: The views expressed in Daily Articles on Mises.org are not necessarily those of the Mises Institute.

Julian Adorney is an economic historian, entrepreneur, and fiction writer. He handles marketing for Mayga Messaging.

Welcome the newest IBC Practitioners
https://www.infinitebanking.org/finder/

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

- Barry Page - Ocean Springs, MS
- Migual Chinea - Bayamon, PR
- Olivia Pham - Blue Bell, PA
- Will Moran - Edmonton, Alberta, CA
- Charlie Jackson - Hillsboro, TX
- Diane Burga - Sherwood Park, Alberta, CA
- Timothy Wolfe - Mount Prospect, IL

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.

The IBC Practitioner has signed the IBC Practitioner’s Agreement with the IBI that specifies that he or she is a financial professional who wishes to advertise his status as an IBC Practitioner, and acknowledges possession of the proper licensing and other legal requirements to practice in his industry. The IBC Practitioner agrees for those clients who want an IBC policy, he will design it according to certain characteristics to ensure that these specific clients are getting a “Nelson Nash” policy, as described in his books and seminars. If an IBC Practitioner is dealing with a client who asks for an “IBC,” “Nelson Nash,” “privatized banking,” or “banking” policy, or if the Practitioner recommends such a policy to the client, and/or if the client has come to the Practitioner by referral from his listing at the IBI website, then and only then the Practitioner must be sure to set this particular client up with a dividend-paying, whole life policy.

As democracy is perfected, the office of the President represents, more and more closely, the inner soul of the people. On some great and glorious day, the plain folks of the land will reach their heart’s desire at last and the White House will be occupied by a downright fool and complete narcissistic moron.” -- H.L. Mencken, The Baltimore Evening Sun, July 26, 1920

We are drowning in information but starved for knowledge. -- John Naisbitt

The first step toward success is taken when you refuse to be a captive of the environment in which you first find yourself. -- Mark Caine
Members, you are not going to want to miss this year's annual Think Tank Conference! Why? Because it returns to Nelson Nash's innovative foundational message that started it all. I know that it's hard to believe, but Nelson will not be teaching forever. This year’s Think Tank is designed around our most cherished resource so that you will have maximum exposure to his invaluable wisdom. He will teach, and share like never before. I promise that you will see Nelson discussing the key elements from *Becoming Your Own Banker* in a way that you haven't heard before. The Think Tank is held in Birmingham, Alabama, on February 5th and 6th. Registration cost is only $400.

*The IBC Practitioner Think Tank is a closed event; only active IBC Practitioner Members, and selected insurance company home office and regional sales personnel are invited to attend. IBC Practitioner membership is defined as those students who have completed the IBC Practitioner Course of instruction, and have joined the 12-month IBC Practitioner Membership, and have remained a member in good standing.*

**Agenda - 5 February**
9:00 am - Doors open for packet pick-up  
10:00 am - Start event - General Session  
12:00 pm - Hosted Lunch  
1:00 pm - 5:00 pm - Live IBC Work Shop featuring Nelson Nash, Dr Robert Murphy, and Carlos Lara. *This 4 hour event will be open to the general public as a separate ticketed event.*  
5:30 pm - Hosted Reception  
6:30 pm - Hosted Dinner

**Agenda - 6 February**  
7:00 am - Hosted Breakfast  
8:00 am - General Session  
12:00 pm - Hosted lunch  
1:00 pm - General Session  
4:00 pm - Think Tank Ends

**Speakers:**  
- Nelson Nash  
- Mark Benson  
- JJ Childers  
- Mary Jo Irmen  
- Carlos Lara  
- Jayson Lowe  
- John Moriarty  
- Robert Murphy  
- James Neathery  
- Jim Oliver  
- David Stearns

**Subjects include:**  
- Client: "Am I too old for IBC?"  
- BYOB - Equipment Financing  
- BYOB - Expanding the System to Accommodate All Income  
- IBC and Estate Planning  
- Neuroeconomics  
- Farming Without the Bank  
- IBC for Canadians  
- IBC Work Shop

If you are a financial services industry professional, want to learn more about the *IBC Practitioners’ Program* and are interested in attending this year’s think tank, it’s not to late to enroll in the program and earn *IBC Practitioner Membership* status. Follow this link to learn how:  
[http://www.infinitebanking.org/practitioners-program](http://www.infinitebanking.org/practitioners-program) or call David Stearns @ 205-276-2977