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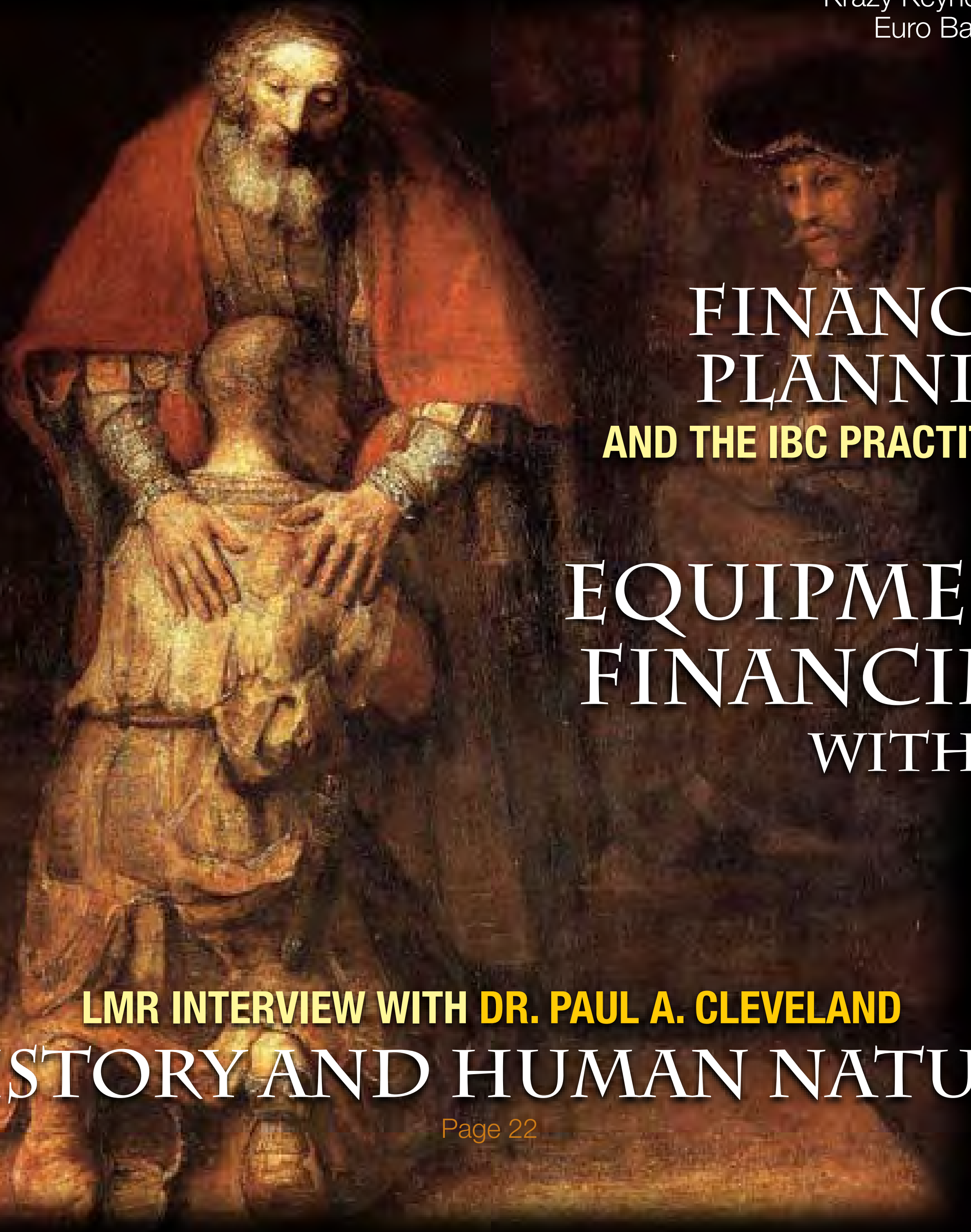
BUILDING THE 10%



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OVERVIEW

ABOUT LARA & MURPHY

L. Carlos Lara manages a consulting firm specializing in corporate trust services, business consulting and debtor-creditor relations. The firm's primary service is working with companies in financial crisis. Serving business clients nationwide over a period of three decades, these engagements have involved companies in most major industries including, manufacturing, distribution and retail. Lara incorporated his consulting company in 1976 and is headquartered in Nashville, Tennessee.

He married Anne H. Browning in 1970. Together they have three children and five grandchildren.

Dr. Robert P. "Bob" Murphy received his Ph.D. in economics from New York University. After teaching for three years at Hillsdale College, Murphy left academia to work for Arthur Laffer's investment firm. Murphy now runs his own consulting business and maintains an economics blog at ConsultingByRPM.com. He is the author of several economics books for the layperson, including *The Politically Incorrect Guide to the Great Depression and the New Deal* (Regnery, 2009).

Murphy is an adjunct scholar with the Ludwig von Mises Institute. He lives in Nashville, Tennessee with his wife and son.

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"It is the masses that determine the course of history, but its initial movement must start with the individual."
- How Privatized Banking Really Works

Dear Readers,

Rembrandt's famous painting, *The Prodigal Son,* graces the front cover of this month's issue of the LMR. This ancient story involves the wayward son, who upon demanding and receiving his father's inheritance, squanders it all in riotous living. When the money runs out the prodigal son comes to his senses. Humiliated, broke and starving he repents and returns home to his father's arms and is lovingly forgiven.

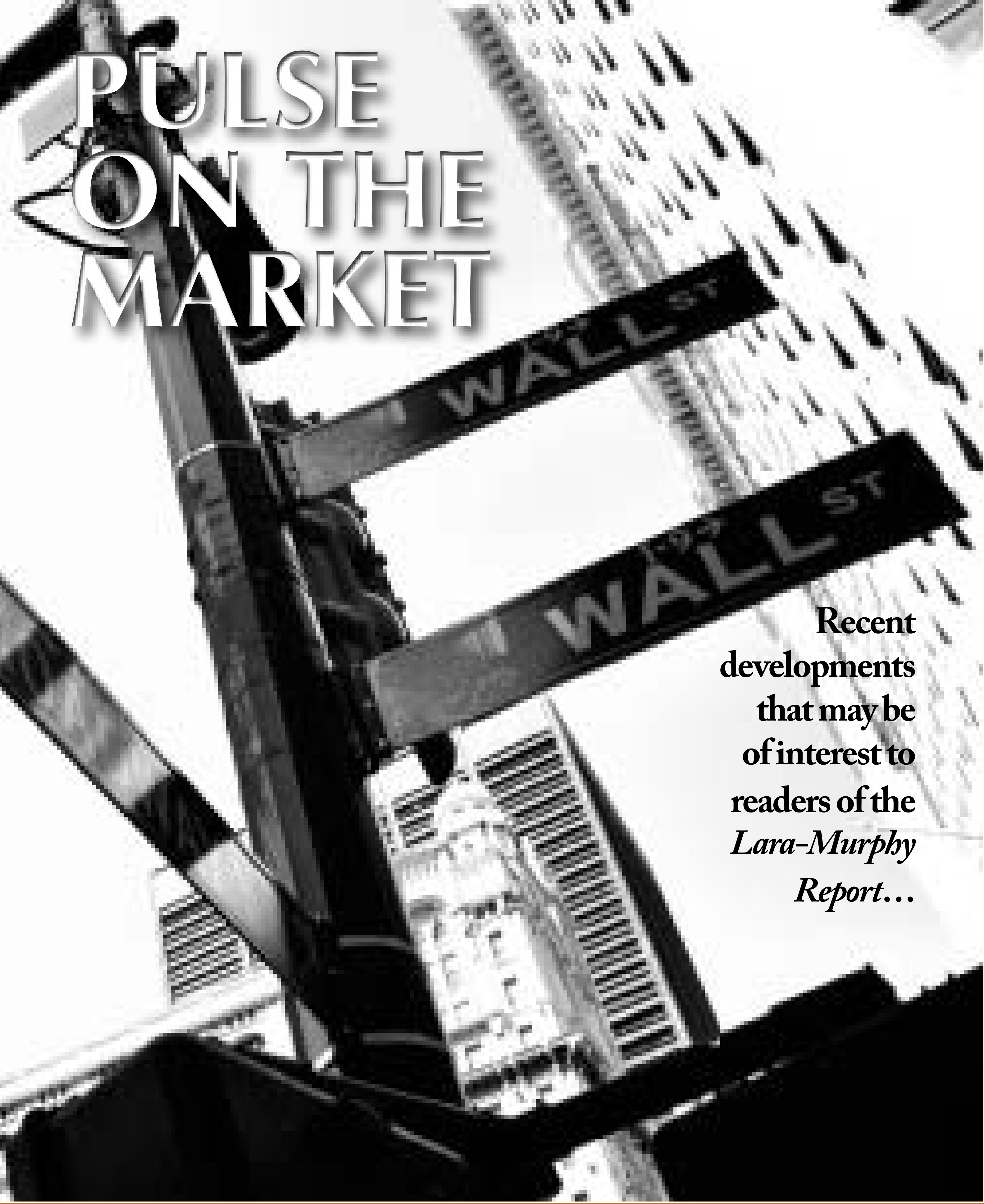
If we take a moment to reflect upon this painting and this story it becomes easy to see our generation in the role of the prodigal son who has not yet been forced to come to its senses. The denial of the inevitable, inculcated long ago by Keynesian economic teaching, has blinded the masses into a belief in an endless fountain of capital that requires no production and savings— *a manner of living at the expense of everyone else.* In *Unmasking The Sacred Lies,* Dr. Paul Cleveland tells how John Maynard Keynes in a symbolic way reversed this story of the prodigal son by making the son the hero and the father the villain. This abrogation has resulted in the squandering of our nation's resources on a massive scale these past seventy-six years.

Austrian economists and the classical natural law theorists before them allow us to see the economies of the world with a new pair of glasses. Harken back to their pure message. Though many have long since left us, their writings are still available and continue to teach us sound economic principles. Draw near to those Austrians who still live and listen to their wise counsel for they will not always be with us. Though they may not always be eloquent or carry the scholastic credentials of mainstream economists, their voices cut through the falsehoods of our day as the great prophets of the ancient world when they preached repentance. Read their books, listen to what they say, learn from them and then do your part in teaching others.

"It is not a procedure to 'get rich quickly.' To the contrary, it requires long range planning. I'm educated as a forester, having worked in that field as a consultant for ten years; I tend to think seventy years in the future. I won't be here—and neither will you—but there is no reason not to behave in this manner. 'Plan as if you are going to live forever and live as if you are going to die today' appears to me to be a good thought. One can learn how to plan and act intergenerationally. That's one of the primary advantages of having been a forester. I learned to think beyond the lifespan of my current generation."
– R. Nelson Nash

Yours truly,
Carlos and Bob

PULSE ON THE MARKET



Recent developments that may be of interest to readers of the *Lara-Murphy Report*…

NY Fed Gets Ready For Money Market Runs. On July 19 Bloomberg reported, "*The Federal Reserve Bank of New York said money-market fund investors should be prohibited from withdrawing all their assets at once as a way to make the $2.5 trillion industry "safer and more fair." Money funds should set aside a portion of every investor's balance as a "minimum balance at risk" that could only be withdrawn with a 30-day notice, the New York Fed's staff said today in a report. The provision would reduce systemic risk and protect small investors who don't pull out of a troubled fund quickly, according to the report.*"

Folks, we don't mean to sound like a broken record, but things are really getting ugly. The people running the show—who have access to a lot more of the details than we mere peons—seem to know that a storm is coming, just as we've been predicting. Whether it's limits on wealthy people taking their assets out of the country (as we reported last month), or limitations on getting your money out of supposedly super-liquid MMMFs, the authorities are putting the infrastructure in place to deal with the next crash. When it comes, do you want your wealth in all of the "safe" places recommended by the popular financial gurus?

Also notice the duplicity of the Fed's report. They are trying to spin their recommendation as an effort to help the little guy, when quite clearly it will hurt the little guy—i.e. the average investor—and help the billionaires running the funds, who get caught with their pants down because they engaged in massive maturity mismatch. As with the rhetoric behind having a central bank in the first place, here too we see things are the exact opposite of the official justifications. The government and Fed implement measures that debase the currency, rob savers, and enrich the plutocrats, and yet these very measures are touted as means of protecting the dollar and the average Joe.

Sounds Fair

Euro Banks Have Friends In High Places. The good news for European banks is that ECB chief Mario Draghi said he would do "whatever it takes" to save the euro. Of course, what this means is that the ECB will create however much new money out of thin air is necessary to sustain the market in European sovereign debt, of which the banks are holding billions. We are wondering just how many times the European public will allow such wealth transfers to occur. We of course are not condoning violence, and many of the people who will be rioting over the coming years have a faulty grasp of market economics, but nonetheless they understand that they are being robbed by smooth-talking men wearing suits. The average citizens in Europe are being lectured on the need for painful "austerity" while certain politicians and international bankers are walking away with billions to compensate for their profligacy.

Euro Bank Bailouts

The Fiscal Cliff Is Coming... Arthur Laffer and Ford Scudder describe in a July 15 Wall Street Journal op-ed the looming tax hit that's baked into the cake: *"The top federal rate on personal income will increase to 39.6% from 35%, with an additional 0.9% increase in the payroll tax for Medicare. The highest federal rate on dividends will increase to 43.4% from 15%, and the tax rate on capital gains will increase to 23.8% from 15%. The rates on capital income are rising because of the expiration of the Bush tax cuts, and a 3.8% tax on investment income for the highest earners enacted as part of ObamaCare.…The highest estate tax rate is scheduled to rise to 55% from 35%, with the lifetime individual exemption dropping to $1 million from $5 million.…In all, federal tax increases total almost $500 billion (over 3% of GDP) per year on a static-revenue basis."*

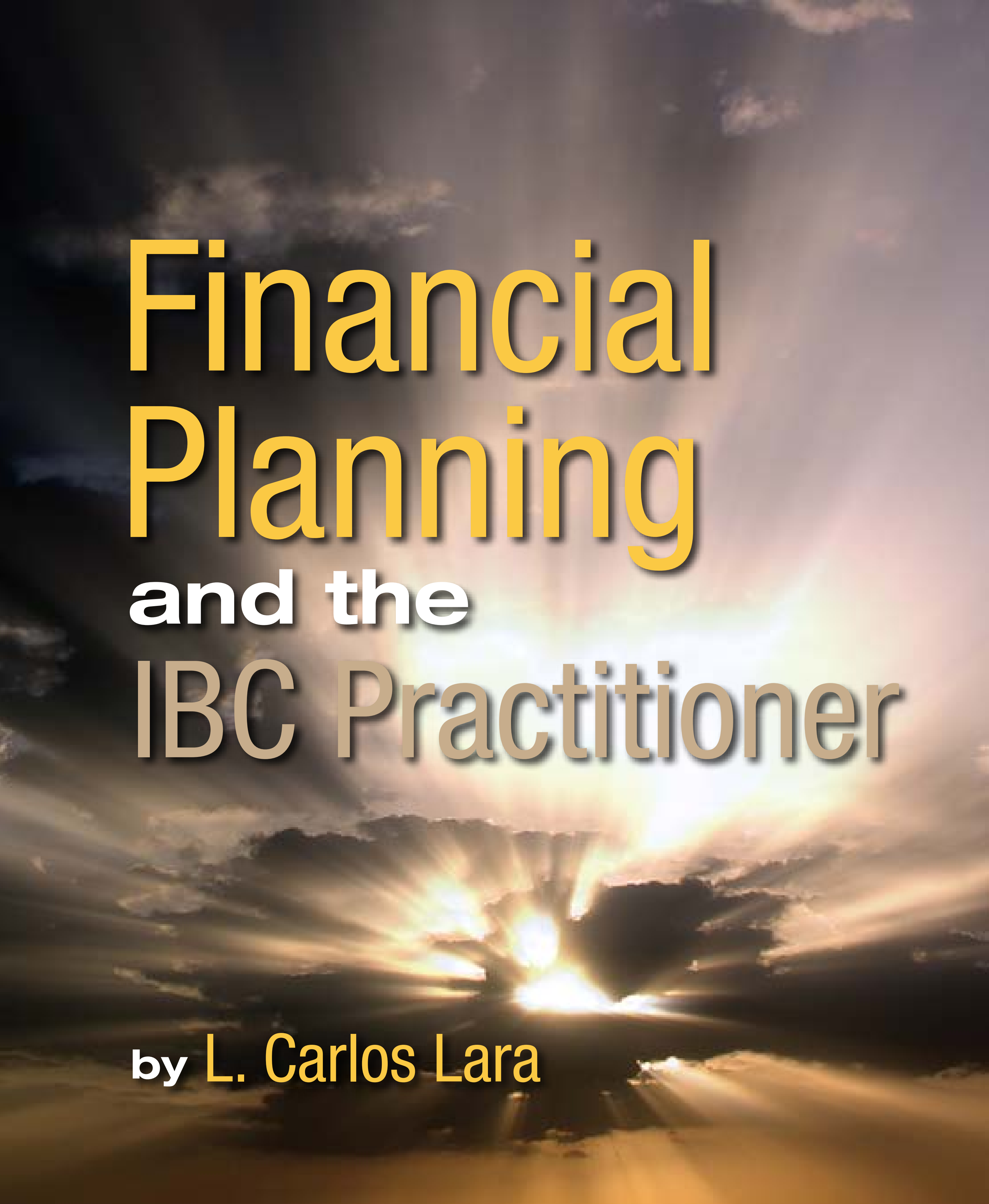
Laffer and Scudder point out that even if the politicians recognize the folly of jacking up tax rates in the midst of a depression—this is what Herbert Hoover tried back in 1932, incidentally, which helped plunge the U.S. into the worst year of its economic history—the damage has already been done. According to a "supply-side" perspective (of which Laffer is a pioneer), people respond to incentives and expectations. If businesses think marginal tax rates are going to rise sharply in 2013, or even if they think there is a decent possibility of this happening, then they will rationally "pull forward" some of their activity into 2012. But if this activity has been pulled forward into 2012, then naturally there is that much less to do in 2013. Thus, we can expect to see conventional measures of GDP, employment, and industrial activity perform very sluggishly in the new year, even if the politicians maintain the status quo on tax rates.

LIKE LEMMINGS WE MARCH

Ezra Klein's Modest Housing Proposal. You really can't make this stuff up. Keynesian pundit Ezra Klein recently suggested—with a straight face—in the Washington Post that the Federal Reserve should announce that it would buy an unlimited amount of mortgage-backed securities until the 30-year mortgage rate reached 2.5 percent. But—and here's the kicker—the Fed would announce that this ridiculously low rate would only last for one year, after which time the Fed would start dumping its holding of MBS and allow 30-year rates to rise toward more reasonable levels. (According to Fed data going back to 1971, the 30-year rate on conventional mortgages is currently 3.49 percent, but historically it was typically above 7.5 percent until the late 1990s.) Klein explains the rationale: *"The message would be clear: If you have any intention of ever buying a house, the next 12 months is the time to do it. This is Uncle Ben's Crazy Housing Sale, and you'd be crazy to miss it."*

The idea is crazy all right. Imagine what would happen to the housing market if Bernanke actually followed this advice. There would be a massive surge in demand for houses in 2013, for the reason Klein cites. This would push up home prices and accelerate construction activity. But, the demand would then collapse from 2014 onward, since anybody who otherwise would have bought a house in that period would have rushed to take advantage of the low rates in 2013. In other words, we would have a one-year housing boom-bust cycle again, the very thing that got us into our current mess. On top of that, the Fed would probably have suffered massive losses on its portfolio, making it that much harder to sell off assets and drain reserves out of the banking sector when price inflation becomes too severe. Typically for short-term Keynesian prescriptions, Klein doesn't even acknowledge these types of problems, let alone deal with them. The goal is simply to get people to spend spend spend, and what better way than to start printing up boatloads of fiat money and lending it out at ridiculously low rates?

KRAZY KEYNESIAN KLEIN



Financial Planning and the IBC Practitioner

by L. Carlos Lara

Dr. Solomon Stephen Huebner was a distinguished professor of insurance at the Wharton School, University of Pennsylvania, and chairman of the Department of Insurance at the institution. He is responsible for having written the very first textbook on insurance in 1915 and introduced the first university-level insurance course in the United States. This earned him the accolade *"the teacher who changed an industry."*[1] By 1998 I had read Dr. Huebner's classic book, *The Economics of Insurance,* in which he introduced the concept of *Human Life Value* and I was most impressed. What one cannot fail to grasp from reading Huebner's writings is the undeniable fact that life insurance is the heart and arteries of a financial plan.

Three years later and shortly after the *Dot-com crash*[2] I was in a classroom on a Saturday morning with a dozen other people listening to a seventy-year-old gentleman speaking about life insurance in a way I had never heard before. That southern gentleman was R. Nelson Nash. In view of the economic conditions of the country, his explanations were powerfully irresistible, and as he talked I contrasted Huebner's concept against Nash's, whose emphasis was the cash value of insurance over the death benefit. Nash's compelling arguments, a mixture of biblical wisdom, philosophy and solid economics, had the sound of truth all over them. Here was a man who used economic common sense in his explanations, an undeniable conviction in actually living what he taught and was totally lacking in fear. I could see he was a man of courage who knew we were all up against a formidable foe and he aimed to defeat it. At the same time, he preached a way of escape to all those who would listen.

In a vain attempt to politely contradict his theory, lest I be swallowed whole by his persuasion, I brought up Huebner. In one polite remark he simply said, *"Huebner was right, but he simply didn't go far enough!"* I was convinced right then and there that Nash's concept not only superseded Huebner's concept, but it also had the power to change the economic landscape of the country. Simultaneously, I realized that Nash would most likely never see the fruition of his dream. The real catalyst that would eventually ignite the spark to a real economic turnaround from the bottom up was the *financial advisor*—the person who speaks to people about their money on a daily basis.

S. S. Huebner

What Nelson Nash has accomplished has given us the great gifts of *vision* and *hope* for the future in a world that many times doesn't make sense. I am grateful he has done it while he still lives—*a legend in his own time.* The IBC practitioner who can become proficient in teaching Nash's message against the broader context of our economy, concurrently implementing the Infinite Banking Concept (IBC) strategies to a public that is desperately in need of financial assistance, is the up and coming, preeminent financial advisor of the 21st Century!

THE HISTORY OF FINANCIAL PLANNING

Financial Planning is the practice of helping individuals or organizations improve their performance, primarily through the thorough analysis of existing financial problems and developing *plans* for improvement. The demand for these and related skills have been with us since ancient times. In this country, the rise of capitalism and the industrial revolution only served to increase this demand. In addition to insurance needs, many people now owned shares of corporations and advice was sought to ensure this wealth.

"Four decades ago, the financial planning profession did not exist. For average Americans, an 'investment' meant a life insurance policy, bought from an insurance salesman who worked on commission. That was all changed by a one-time vacuum-cleaner salesman who had transformed himself into a marketing consultant and motivational writer, and a former insurance salesman turned school-supplies salesman who had a master's degree in psychology. In 1969, they began a revolution that was intended to help ordinary Americans gain control over their financial destinies. Despite huge odds, 'financial planning'—the first new profession in four centuries—succeeded beyond the most fervent hopes of its founders, not just in the United States but also around the world.

"Forty years after the profession's inauspicious birth, there are more than 120,000 CFP professionals around the world, educated in scores of colleges and universities."

The History of Financial Planning
E. Denby Brandon, Jr. and H.Oliver Welch [3]

We all know that many types of investments, as well as life insurance, are financial products that must be sold, an obvious truth in the financial services industry. As stated earlier, Huebner empowered the insurance agent to couple the sale of insurance products with the ability to provide planning services. In essence, the insurance agents were the first and, in many respects still are, comprehensive financial planners. Today there are approximately 746,000 licensed financial representatives in this country representing over 7,000 banks, nearly 1,000 brokerage firms and 2,300 insurance companies. All of these institutions sell financial products. The numbers of public accountants and lawyers are legion. Yet with all the benefits of professional assistance in navigating through a maze of tax laws, the fine print on financial products and risk variables in investment prospectuses, the public is more confused than ever. Clearly, advice offered by many in the financial services industry is not providing the help that is most needed because their advice merely scratches the surface of the real problem. A person's poor judgment, undisciplined money management or lack of time to expertly research every aspect of financial decisions may be the culprit in some cases, however, the real problem stems from a completely different source. It is ***government intrusion*** and, especially, ***monetary policy*** which is at the core of this money problem.[4]

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>
> **[Nash] simply said, "Huebner was right, but he simply didn't go far enough!" I was convinced right then and there that Nash's concept not only superseded Huebner's concept, but it also had the power to change the economic landscape of the country.**

Since the stock market crash of 1929 Congress pushed through legislation with the official goal of protecting small investors from a recurrence of that event. The Securities Act of 1933, the Securities Exchange Act of 1934 and the Investment Advisors Act of 1940 all established guidelines for regulating the investment industry while providing disclosure and investor education. Following the establishment of these firm boundaries, very little changed in the financial services industry during the ensuing thirty years, but there was now a distinct legal separation between banking, Wall Street firms, and life insurance companies.

With the increasing encroachment by government into virtually every sector of the economy, and the simultaneous rise in *inflation,* brought about by the closing of the gold window in 1971, the financial needs of Americans became more urgent and complex. The financial advice business also grew and became more specialized. Except for the members of the Austrian community such as Mises, Hazlitt, Hayek and others, very few knew what lay ahead in the domestic and global markets if the United States didn't reverse its course. Their message was simple. The only way out of the impending financial crisis of the future was for government to get out of the way and free up the markets…*completely!* That message specifically implied the return to *sound money.* That message was ignored.

As a young man entering this new profession in the early 1970s I did not realize that no other sector of the economy was as intertwined with the government as the financial services industry. Still, the *consulting* profession in the early years was not yet excessively encumbered. All those constraints would come much later whereby only government-approved financial firms would have a chance to enter and compete equally in the market. Nevertheless, in those early years, I pursued my career and chose to distinguish myself from all others entering the field by selecting a unique specialty within this new profession—*business insolvency.* More accurately, I became a *workout specialist* for businesses in financial distress. This meant dealing specifically with businesses, but of course, many business firms, especially closely held corporations, have been built around a single individual or family. To this extent there is and always has been a close affinity between businesses and individuals. Consequently, financial services provided to one would automatically benefit the other. They are inseparable.

As the years went by the signs predicted by the Austrians began to appear, but it also became clear that most people could not see or hear the message. However, after each boom and bust cycle, it was undeniable, painful and clearly visible. Each time bankruptcy and liquidation permeated various sectors of the economy as the result. But the big one was still years away. The more I became an expert in handling these special types of business problems, the more it became apparent to me that government subversion of the market and current monetary policy as implemented by the Federal Reserve were the single biggest causes of all business and personal financial crisis.

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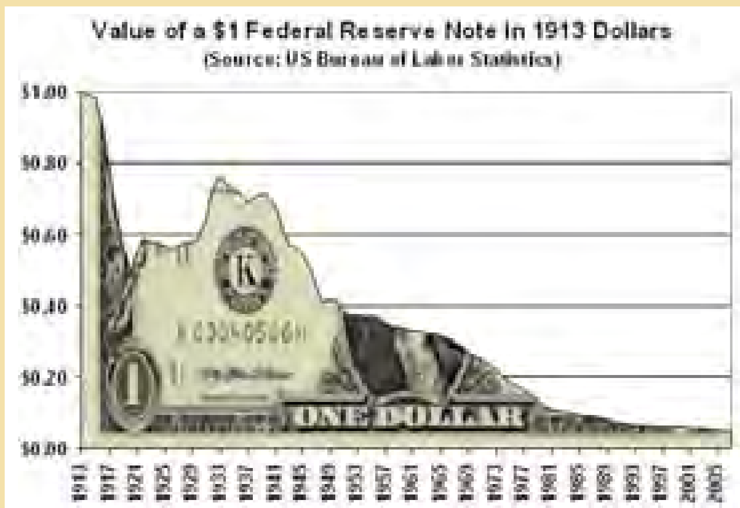
by many in the financial services industry is not providing the help that is most needed because their advice merely scratches the surface of the real problem.



THE FEDERAL RESERVE AND THE GOVERNMENT PROTECT A SELECT FEW

As we all know, not all government intervention is negative to the financial industry. What we have all seen, especially since the 2008 financial crisis, is that not all businesses are the same. Businesses, especially big ones, receive special government treatment. When the Federal Reserve exercises quantitative easing and creates money out of thin air, the first to have use of it is the government-sanctioned banking monopoly, followed by all those other large firms with membership in the *"too big to fail"* club. These are the established, yet poorly run financial firms that, more often than not, specialize in *derivatives.*[6] They are able to exist and navigate the regulatory maze solely through the use of subsidized handouts from the government. The continual propping up of these institutions is making the individuals that run them extremely wealthy at the expense of the economy's legitimate producers, savers, and investors. When these convoluted banking mechanics are implemented by the Fed and mandated by government, they fool and entice unsophisticated investors and entrepreneurs into ventures that are far riskier than they appear on the surface. The results are the creation of *moral hazard,*[7] exacerbating the instability of the financial system. At the same time, all other financial firms, especially the smaller ones, suffer and are eventually eliminated from competition by costly and increasingly burdensome regulation. As recently as last night over dinner, a registered financial advisor informed me that his small financial firm is now being required to keep a record of conversations with their clients on file for 21 years. How ridiculous. He's 70 years old! Still, Congress believes more regulation is absolutely necessary to solve our economy's problems and prevent another financial crisis. In actuality, more regulation only burdens the economy. The squandering continues unabated by the powerful, the elite and the select few.

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RETIREMENT? —IT'S AN ILLUSION FOR THE AVERAGE AMERICAN

There is absolutely no way for the average American to retire in light of what we have just stated. There is no way to do it without first having stockpiled a substantial amount of real savings. An average annual $60,000-$100,000 in retirement income requires a stockpile of several million dollars. The average citizen in today's economic environment simply cannot do it without a complete reversal in thinking about retirement. This disassociation with reality by most Americans on the subject of retirement was recently explained in a *New York Times* article entitled "Our Ridiculous Approach to Retirement" written by a professor of economics who specializes in the economics of retirement. In it she points out:

"Seventy five percent of Americans nearing retirement age in 2010 had less than $30,000 in their retirement accounts. The specter of downward mobility in retirement is a looming reality for both middle and higher income workers. Almost half of middle-class workers (49%) will be poor in retirement, living on a food budget of $5 a day. To maintain living standards into old age we need roughly 20 times our annual income in financial wealth. If you earn $100,000 at retirement, you need about $2 million beyond what you will receive from Social Security."

—Teresa Ghilarducci[8]
New York Times
July 21, 2012

Of course we already know Social Security cannot be relied upon, but these recent facts documented by Ms. Ghilarducci are true.

Americans know they need to save; they simply cannot. Unless they can become fully informed of the real source of their money problems, they will not be able to solve this dilemma. It can all be so overwhelming that people go into denial. To put it simply, *life* has a way of completely derailing the best and most disciplined savings plan. For example, the fear of losing one's employment is a constant threat to individuals these days. Also, a serious accident or illness that incapacitates the breadwinner for extended periods of times can deplete savings and limit income. Bankruptcy is frequently inevitable under any one of these circumstances. The same is true in the case of divorce or other form of lawsuit. What about the untimely death of the breadwinner? Yes, life, as we all know, is fragile and filled with uncertainties. When these life events are coupled with severe money problems there is no way to save for retirement. Is there any wonder why Americans are forced to turn to the government as the ultimate caregiver? Finally, the current housing crisis has added insult to injury. The American home, one of the most sought after dreams and a storehouse of savings for most Americans, has been completely undermined. Americans are feeling a sense of total defeat and hopelessness.[9]

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IT'S TIME TO GET SERIOUS

Today we find ourselves on the verge of yet another catastrophic financial meltdown, bigger and even more destructive than the one experienced in the fall of 2008. We all know we are facing major monetary defaults on several fronts. It's all over the news! The wiggle room has gotten much tighter. How are we preparing for it? If ever, there was a need for a totally new form of financial planning, it's certainly now. In the current environment traditional financial planning is virtually irrelevant. This was the primary reason Robert and I wrote *How Privatized Banking Really Works.* It became abundantly clear that we are not in control of our money and what little money we think we do have in our control is becoming worthless. The financial advisor of the future must be able to speak with his clients on these realistic terms in an educational manner. The purpose is not to scare the public, but rather to insist that the public not remain naïve. The Federal Reserve and government intervention must be brought into the financial planning conversation by financial advisors that know how to explain it. The strategy implemented must be presented in light of this broader context if it is to make sense. The new plan of the future must give the client the eyes to see clearly. *Control, liquidity* and *exit strategies,* with thorough explanations of how everything is *monetized*[10], should be introduced in a logical manner.

In light of this paradigm, ***John Exter's Pyramid of Collapsing Values***[11] is worth studying. John Exter (1910-2006) was an American economist, a member of the Board of Governors of the United States Federal Reserve System. When he first presented this model in 1973, Exter was describing a collapse of the economy. In a panic the idea is to move downward. Note that gold is the money of last resort and appears at the bottom of the pyramid. The problem is that we can't actually use gold as money until everything collapses. In the meantime, where are you currently invested? For the IBC Practitioner the orange and yellow areas of the pyramid are of particular importance because this is where the life insurance sector has our money. When meeting with clients, he must be fully prepared to explain why, given the current economic climate and compared to all other financial products, the IBC-designed insurance policy provides the safest residence for his money until he is ready to utilize it.

PRIVATIZED BANKING

Let's not forget that the cash flow of the economy runs through these three large pools of money— *commercial banks, Wall Street firms and insurance companies.* This cash flow is virtually out of our control but in control of the Federal Reserve and government. Given this closed money environment, we have to exercise sound thinking in determining where we will place the money in our possession and for what purposes. Our sole purpose should be to practice privatized banking.

"Once fully understood, these three ideas (Austrian Economics, The Sound Money Solution and Privatized Banking, as described by R. Nelson Nash) provide the basis for a formula with powerful turnaround dynamics that may be implemented by virtually any individual. The result is a private economic enterprise and self-perpetuating teaching tool that

provides the individual the savings, banking, and financing capabilities he needs to acquire all of his material needs, plus the power to literally reconstruct national monetary policy. It is these benefits that are the key to keeping the individual inspired as he spreads the message to others. As the message grows, public opinion will change.

This is, finally, a solution that answers the question of what one person can actually do that will make a difference in an economic environment that has gone terribly awry."

—How Privatized Banking Really Works[12]

CONCLUSION

Never before in the history of America has there been a more desperate need for truthful economic education than the one we face today. Is it possible that a small group of *free market thinkers* such as ourselves, *entrepreneurs, lovers of liberty, champions of sound money* even stand the smallest of chances of reversing the course of this country with our own brand of revolution and against such insurmountable odds? The challenge is certainly enormous. Yet this will be the calling of tomorrow's financial planner.

We speak of the IBC Practitioner, whoever he may be. Inspired by Nelson Nash, and all those great Austrians before him, it is he who can get this job done. Now he must step forward and announce himself. "I am he, send me!"

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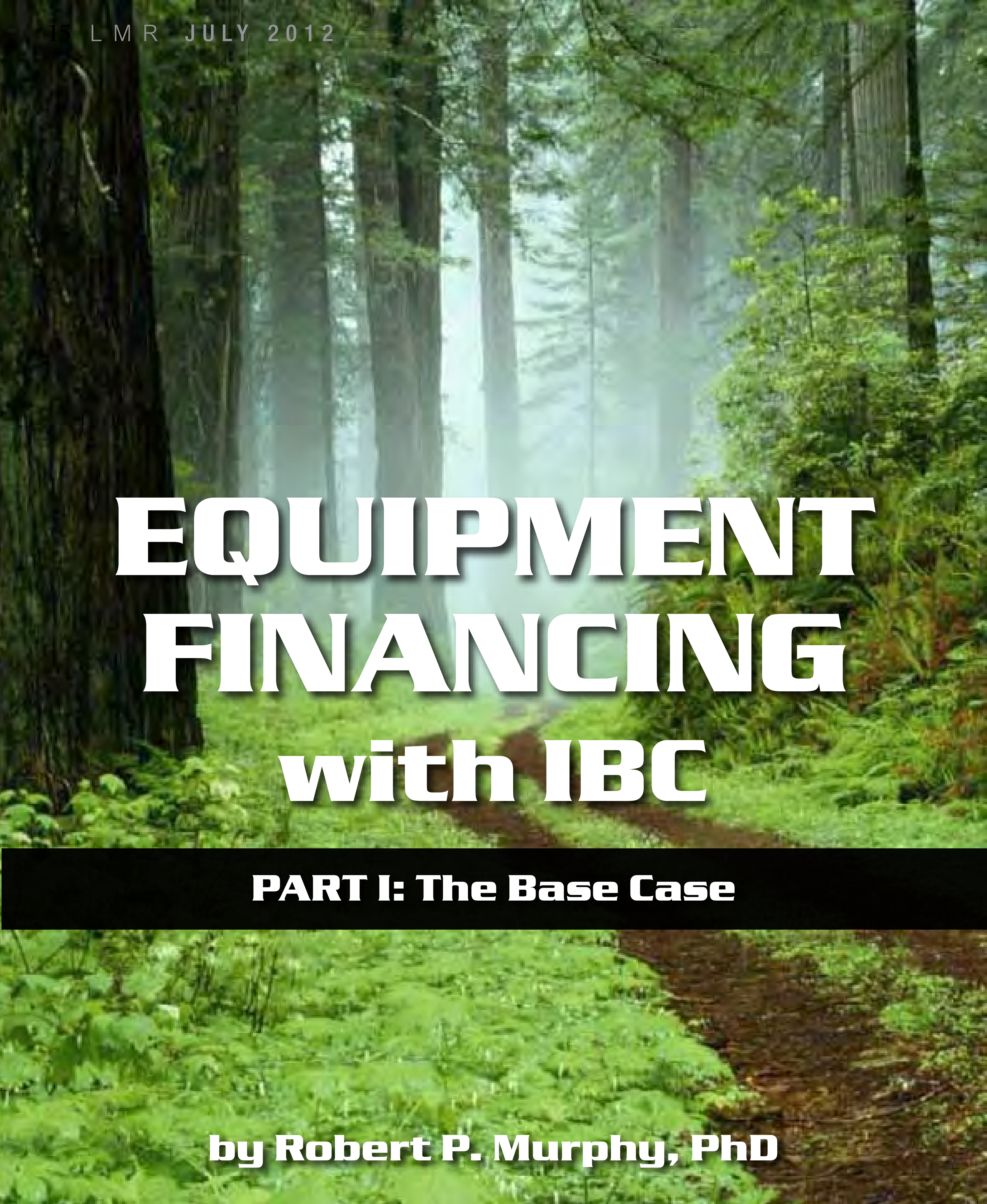

EQUIPMENT FINANCING with IBC

PART I: The Base Case

by Robert P. Murphy, PhD

Regular readers of the *Lara-Murphy Report* know that we are strong advocates of the Infinite Banking Concept (IBC) as developed by R. Nelson Nash in his classic book Becoming Your Own Banker. In this work, Nash showed how the proper use of dividend-paying whole life insurance could allow someone to finance major purchases through policy loans, rather than seeking out traditional lenders. In our own book, Carlos and I put Nelson's ideas in a broader economic framework and showed how IBC would allow a household to engage in "privatized banking."

In the present article (the first of two parts) I want to walk the reader through one of the most important parts of Nelson's book, namely Part IV on Equipment Financing. After extensive study of the theory and practice of whole life insurance, as well as discussion with Nelson himself, I believe I can shed some light on the illustrations on this topic. My goal is to "connect the dots" and make sure the reader of Nelson's book understands exactly how the different numbers fit together.

Before diving into the details, I should offer a general disclaimer: Nelson was quite clear in his book—and with me on the phone—that IBC isn't "about" interest rates. Rather, Nelson is showing his readers how to cut out the middleman of a commercial bank or other institutional lender, through the use of dividend-paying whole life insurance policies. Naturally, if a person can redirect cash flow that otherwise would have gone out of the household and steer it back in, then the person will be wealthier.

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Rather, Nelson is showing his readers how to cut out the middleman through the use of dividend-paying whole life insurance policies.

However, having said all that, it is still the case that a standard assessment of rates of return and so forth will show—as it must—that a person does better financially by using IBC. The illustrations in Nelson's book show this, and the goal in the present article is to demystify some of the numbers to make the presentation less of a black box.

First, the Control (Baseline Case)

The context of our discussion is a hypothetical person who runs a logging company with four trucks. Initially, the man finances all four trucks through a conventional, outside lender. For each truck, the man must finance $52,600, which he does over a four-year period before turning in the truck and buying a new one. Based on the specific details that existed when Nelson constructed the example, the market rate of interest on this commercial loan was a bit higher than 15%. Since the man (by assumption) turned in the trucks every four years, it worked out that 27 cents of every dollar paid to the finance company was in the form of pure interest.

Eventually Nelson will show the reader the benefits of self-financing the truck purchases through policy loans on well-funded whole life policies. But Nelson doesn't want to overwhelm the reader, so he moves in baby steps.

The first thing to establish is a control, or baseline, case. In order to isolate the pure effect of *IBC*—becoming your own banker—Nelson wants to lay down a background of a normal whole life policy where the owner does *not* take out any loans.

If the owner merely contributed

$15,000 per year (through 65), and if the owner took all dividends in the form of cash and spent them on beer and wings, then the face death benefit would never increase.

Once we see the performance in this scenario, we can test what happens when the person begins using this identical whole life policy to start financing logging trucks.

Table 1 on the next page is an abridged version of Nelson's "Equipment Financing Illustration 1," which appears on page 54 of the Fifth Edition.

The Basics of Reading an Insurance Illustration

For newcomers to IBC, merely interpreting illustrations such as the one shown in Table 1 can be daunting, because there are several moving parts and it's hard to know what is causing what.

First of all, Nelson is assuming that there is a "life paid up at 65" policy with a base premium of $15,000 and an initial death benefit of $1,233,439. (This information appears at the top left of the illustration in Nelson's book.) This means the owner of the policy is contractually obligated to pay $15,000 per year in premiums until age 65, at which point he no longer owes the insurance company any money.

Now, if the owner merely contributed $15,000 per year (through 65), and if the owner took all dividends in the form of cash and spent them on beer and wings, then the face death benefit would never increase. It would still be $1,233,439 at age 84, at the bottom of the illustration. This is because the man would still just have his original base policy, on which he kept paying the $15,000 premium. There would be no *additional* purchase of insurance, and so the death benefit would remain the same.

AGE	NET ANNUAL OUTLAY	TOTAL DIVIDEND	NET CASH VALUE YR END	CUM NET OUTLAY	DEATH BENEFIT
30	$40,000	$0	$24,029	$40,000	$1,347,420
31	$40,000	$0	$65,282	$80,000	$1,448,237
32	$40,000	$2,821	$109,637	$120,000	$1,565,319
33	$40,000	$4,494	$157,363	$160,000	$1,684,787
34	$0	$6,339	$167,182	$160,000	$1,651,077
35	$0	$6,359	$177,803	$160,000	$1,617,227
36	$0	$6,827	$189,303	$160,000	$1,586,373
37	$0	$7,393	$201,772	$160,000	$1,558,701
38	$0	$8,032	$215,294	$160,000	$1,534,303
39	$0	$8,735	$229,940	$160,000	$1,513,222
40	$0	$9,500	$245,790	$160,000	$1,495,466
41	$0	$10,325	$262,987	$160,000	$1,481,114
42	$0	$11,273	$281,585	$160,000	$1,470,253
43	$0	$12,233	$301,720	$160,000	$1,462,786
44	$0	$13,296	$323,507	$160,000	$1,458,790
45	$0	$14,409	$347,078	$160,000	$1,458,250
46	$0	$15,634	$372,555	$160,000	$1,461,233
47	$0	$16,910	$400,109	$160,000	$1,467,729
...	...	...	...	...	...
64	$0	$66,577	$1,408,285	$160,000	$2,284,301
65	$0	$71,942	$1,517,320	$160,000	$2,406,948
66	$92,000	$76,620	$1,535,083	$68,000	$2,388,186
67	-$92,000	$77,785	$1,553,719	-$24,000	$2,366,852
68	-$92,000	$79,063	$1,573,317	-$116,000	$2,348,032
69	-$92,000	$80,346	$1,593,760	-$208,000	$2,331,513
70	-$92,000	$81,504	$1,615,244	-$300,000	$2,317,164
71	$92,000	$82,915	$1,637,846	$392,000	$2,305,388
72	-$92,000	$84,504	$1,661,661	-$484,000	$2,296,355
73	-$92,000	$86,348	$1,686,737	-$576,000	$2,290,342
74	-$92,000	$88,419	$1,713,164	-$668,000	$2,287,491
75	-$92,000	$90,626	$1,740,933	-$760,000	$2,287,799
76	$92,000	$92,892	$1,769,997	$852,000	$2,291,093
77	-$92,000	$95,007	$1,800,385	-$944,000	$2,297,030
78	-$92,000	$97,032	$1,832,206	-$1,036,000	$2,305,422
79	-$92,000	$98,942	$1,865,492	-$1,128,000	$2,316,087
80	-$92,000	$100,818	$1,900,340	-$1,220,000	$2,329,013
81	$92,000	$102,769	$1,936,871	$1,312,000	$2,344,345
82	-$92,000	$104,913	$1,975,174	-$1,404,000	$2,362,370
83	-$92,000	$107,355	$2,015,361	-$1,496,000	$2,383,436
84	-$92,000	$110,096	$2,057,446	-$1,588,000	$2,407,736

TABLE 1

(Note that for ease of comparison, we have shaded the same cells in Table 1, as Nelson shades in his Illustration 1, even though our discussion will not necessarily refer to these same cells.)

Even in this case, where the man maintains the original base policy and death benefit coverage, the *net cash value* would still increase, year after year, starting a few years into the policy. A standard whole life policy is designed such that the cash value steadily rises until it just equals the face death benefit when the policy matures or completes (which used to happen at age 100, but now might not occur until age 121). So the growth in cash value is a natural feature of a whole life policy, and isn't *solely* the result of reinvestment of dividends.

However, in Nelson's first illustration he assumes that the man *does* pump more money into the policy. Nelson does this, because—to repeat the point from before—he wants to have a true apples to apples comparison. When the hypothetical man wants to finance one of his logging trucks with the policy, there will need to be enough cash value in the policy to handle the loan.

If the purchase of additional insurance causes the death benefit to go up, a partial surrender does the opposite.

Such a large policy loan anytime soon will only be possible if the man has "front-loaded" the policy with large, additional payments above the contractually required $15,000 per year. Since the man is going to need to do this in Illustration 2 (and beyond), Nelson needs to have the man front-load the policy in the control case, Illustration 1, so that we can isolate the pure effects of truck-financing.

Buying Additional Insurance

We can see the front-loading in Table 1, where the first four years show a net outlay of $40,000 per year. What has happened is that in addition to the base $15,000 premium payment, the man has also elected for the option of a Paid Up Additions (PUA) rider, in the amount of $25,000. This allows him to supplement the base premium with an additional amount, so that the total contribution is $40,000.

When someone buys additional insurance, effectively he is buying "mini-policies" modeled after the original, base policy. The special thing about these additional mini-policies is that they are fully funded at inception. In other words, they are a "1-pay" insurance policy. Standard illustrations don't keep these different policies distinct, but instead lump the cash value, dividend payments, and face death benefit of all policies together into single values shown in the various columns for a particular year.

This is why the death benefit appears to grow in an illustration showing the purchase of additional insurance. It's not that the death benefit on the original policy *per se* has increased, but rather that the owner is buying more insurance policies—which are "1-pay" and are otherwise calibrated to be just like the original policy—that, for convenience, are thrown in a bucket with the original policy where only the totals are reported.

Partial Surrenders

If the purchase of additional insurance causes the death benefit to go up, a partial surrender does the opposite. Here, what's happening is that the owner is surrendering or collapsing some of the "mini-policies" he has accumulated along the way; it is the unwinding of paid-up additional insurance. As with the original policy, with a mini-policy the owner obtains the "surrender cash value" upon surrender. However, this amount might be fairly small, since the 1-shot payment to fully fund the mini-policy was itself relatively small.

Because he didn't want to use any policy loans at all—again, in order to isolate their impact in the next illustration—in this control case Nelson has the hypothetical man make his $15,000 base premium payments from Age 34 onward through the use of dividends and partial surrenders. For example, at Age 34 the dividend is $6,339. That's not enough to cover the full $15,000 contractually due, so the man must partially surrender some of the additional (fully paid up) insurance he has accumulated by this point.

In order to raise the $15,000 - $6,339 = $8,661 necessary, the man must surrender insurance with a face death benefit of $33,710. This is why, in Table 1, we can see the death benefit drop from Age 33 to Age 34, by the amount of $33,710. Note that from Age 30 through 33, the death benefit had been increasing—because of the additional $25,000 plus dividend earnings. Yet this trend reverses at Age 34, because now the owner needs to come up with some of the $15,000 premium payment, and is drawing on the accumulated, fully-paid up insurance to do so.

The pattern flips again at Age 46, where the death benefit ($1,461,233) is higher than it was at Age 45. What is special about this particular time? Why did the death benefit continually go down, year after year, from Age 34 through 45, after which it started rising again?

The answer is that the total dividend finally surpassed the $15,000 mark at Age 46. At this point, the man no longer needed to partially surrender insurance coverage in order to come up with the premium on the original, base policy. In fact, his dividend of $15,634 this year, leaves him with a spare $634 that will be devoted to the purchase of additional paid-up insurance. Thus, rather than surrendering, the man now begins buying more insurance.

Passive Income Stage (aka "Retirement")

Things continue in this fashion for two decades until Age 65. At this point, the original base policy is paid up (by contractual design) and so the man no longer owes $15,000 annual premium payments. Note that the death benefit this year is $2,406,948.

Now, Nelson wanted to show the power of whole life, even without getting into IBC financing *per se.* So he tinkered with numbers until he found the amount that the man could draw out of the policy, such that after 19 years (i.e. at Age 84) the man would have (roughly) *the same* death benefit available. This magic number happened to be $92,000. Thus, as Table 1 indicates, the man can draw $92,000 in passive income ("retirement income" in popular jargon) every year from Age 66 through 84, while his death benefit at the end is almost the same (actually $788 higher) as it was at the start of the process. What Nelson was trying to convey here is that the standard whole life policy, so long as it has been heavily capitalized on the front end, can provide a very comfortable flow of passive income in later years, and still deliver a sizable bequest to the owner's beneficiaries.

Note, however, that the death benefit doesn't stay constant. What actually happens is that it initially falls for several years, then turns around and begins rising. Nelson has picked the numbers such that the fall and rise virtually offset each other, yielding start and end death benefits that are almost identical. But what's the cause of this fall

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and make sure the reader of Nelson's book understands exactly how the different numbers fit together.

and then rise?

The answer again lies with the dividend column. Notice that when the death benefit is shrinking from Age 66 forward, the dividend is *less* than $92,000. That means to get the full $92,000 in passive income during this period, the man needs to partially surrender some of the paid-up insurance to cover the deficit. But eventually, the dividend itself surpasses the $92,000 mark, at which point the death benefit begins rising again. For example, at Age 76 the dividend is $92,892, meaning that $892 is available for the purchase of additional paid-up insurance.[1]

Conclusion

Even at this stage, before we've talked about policy loans, we can see the tremendous power of a whole life insurance policy that has been heavily funded at its inception. To be clear, Nelson isn't recommending that people actually use such a policy in the way he's made his hypothetical man behave. The point is that Nelson was trying to pick a very simple baseline case, which involved no policy loans, so that the benefits of IBC would be apparent in contrast.

In the August 2012 issue of the *Lara-Murphy Report* I will complete this discussion. I will cover the tax implications that are applicable even in this Illustration 1, and show why Nelson thinks it would actually be foolish to obtain cash through partial surrenders as his hypothetical logger has done. Following that, I'll dive into the true equipment financing scenario, and show how the logger can improve on an already good situation by "becoming his own banker."

(1) A note to purists: Technically, the death benefit turns around and begins rising at Age 75, when the dividend is only $90,626, i.e. less than $92,000. One would have expected the death benefit to fall in this year as well. I have discussed this anomaly with Nelson, who conjectured that it could be due to rounding or perhaps a subtlety with monthly/annual timing in the way the insurance company's software program generated the illustration.

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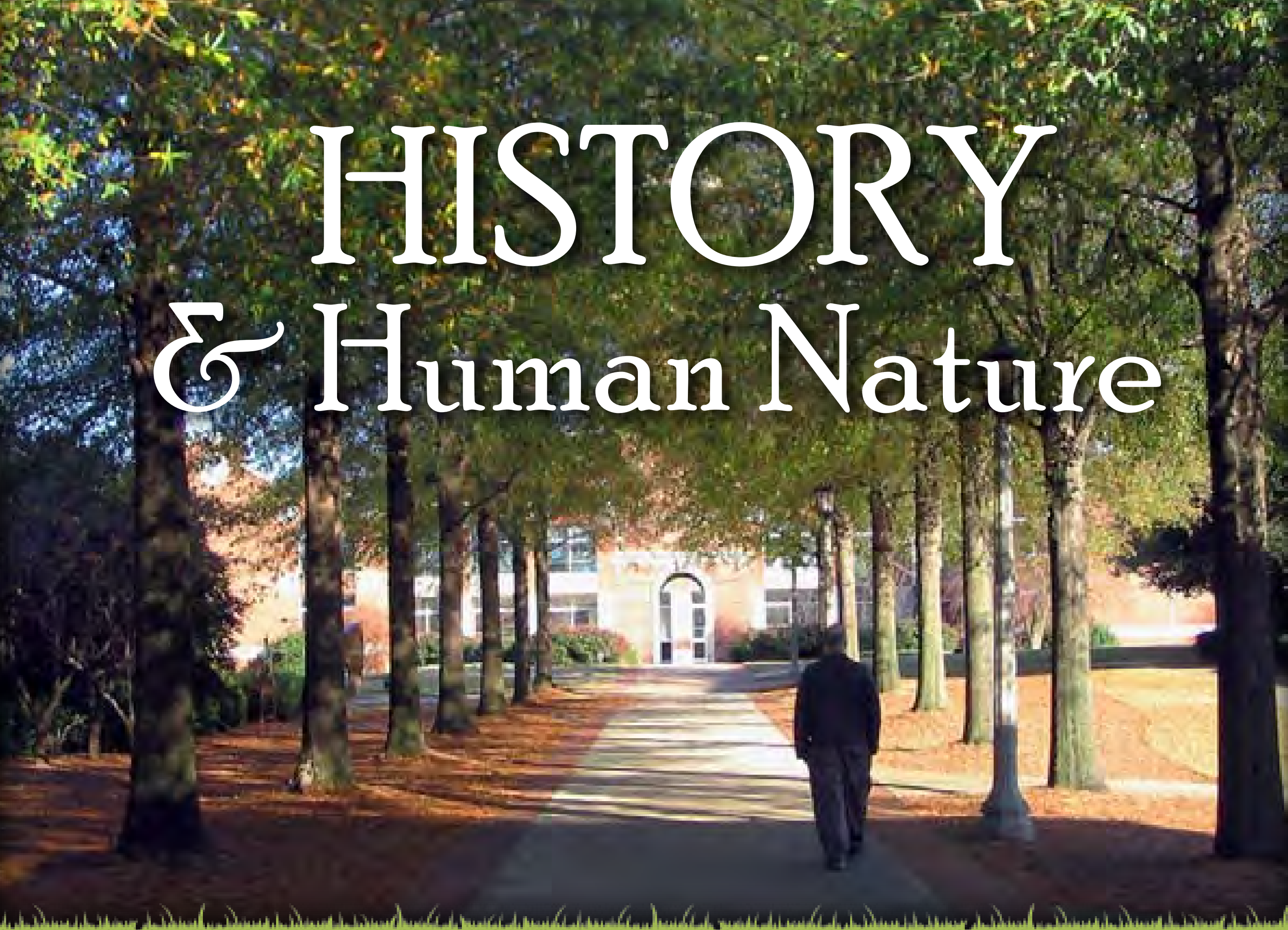
HISTORY & Human Nature



PAUL A. CLEVELAND

is a Professor of Economics and Finance at Birmingham-Southern College. He received his Ph.D. in Economics from Texas A&M. Cleveland is the author of two books: *Understanding the Modern Culture Wars* and *Unmasking the Sacred Lies,* and the co-author of the third edition of *Basic Economics* with Clarence B. Carson. His academic articles have been published in numerous places including the *Journal of Private Enterprise, the Independent Review, the Journal of Markets & Morality, Religion and Liberty,* and *Areopagus Journal.*

Lara-Murphy Report: How did you discover Austrian economics?

Paul Cleveland: I was briefly exposed to Mises' work during my college days at Auburn University, mainly in my courses on the history of economic thought. However, I really began to pursue the writings of Mises, Hayek, Rothbard, and others starting around 1989. I attended a Foundation for Economic Education (FEE) conference in the summer of 1990 that really jump-started my thinking. From that point forward, I think the bulk of my studies in economics were written by Austrians.

LMR: One of your biggest influences is Clarence Carson. He is not widely known, yet the people who are familiar with him believed him to be a giant. Who was he, and why is it important for current Austrian economists to read him?

PC: In my view, Clarence was a prime example of a gentleman scholar working in the classical tradition. Throughout his career, he was a student of history with a primary focus on American history. He received his Ph.D. in history from Vanderbilt. For Clarence, history was about human action. He rejected the increasingly popular historicism that treats humanity as if it's some sort of herd being moved here and there by the force of society. Rather, he understood well that history is driven by the actions of individual people working in isolation or together. He understood that their ideas and beliefs matter in forming their affections and ultimately leading them to undertake certain courses of action. Such an understanding goes hand-in-hand with the praxeology [the science of human action—eds.] of Austrian economics. It is why there remains today such a strong focus on history within the Austrian school.

LMR: In addition to being an economics professor, you are also a ruling elder in the Presbyterian Church in America (PCA). In your view, are these hermetically sealed compartments of your life? After all, many of the greatest names in Austrian economics and libertarianism were atheists or agnostics. Do you think the Christian believer sees aspects of political liberty and the nature of man, that these others cannot see because of (what you perceive to be) their flawed metaphysical view?

PC: These are absolutely *not* hermetically sealed compartments! As a matter of fact, it was the revival of my Christian faith that led me to embrace Austrian economics. The reason why is that mainstream economics today is dominated by the notion that human behavior is driven solely by utility maximization in a narrowly defined way. That is, the assumption is that the individual person is really nothing more than a calculator of sorts. In this sense, one's behavior is no different from any other animal and deterministic. As such, the concept of personal choice and responsibility is destroyed. As B. F. Skinner attempted to argue in his book, *Beyond Freedom and Dignity*, behavioral determinism leaves no room for such things as volitional choice or the dignity of the individual person,

> IN MY VIEW, Clarence was a prime example of a gentleman scholar working in the classical tradition.

and utilitarianism essentially embraces such a view. Alternatively, Austrian writers maintain a view of the person that is consistent with the notion that all people bear the image of God. That is, for Austrians people are volitional and capable of understanding the world and acting in it. While many of the writers might not share my faith, they do share my understanding of human nature and that is the key. I actually think that Christianity is important to a full understanding of economics since it addresses the crucial question of the establishment of the natural law that defines the boundaries of successful human action. In particular, not only does reason confirm that stealing from others can never lead to successful economy, but that is reinforced and strengthened biblically by the reality that our Creator Himself has established this order.

LMR: We encounter many people who say, "I've tried reading Nelson Nash's book on the Infinite Banking Concept, but I just don't get it." You've said many times that it took you quite a while to "get" what Nelson is doing in his classic book. Can you explain your struggle, and give tips to the newcomer to make the journey easier?

PC: Nelson's book did not exist when he first began to teach me the IBC concept. At the time I was teaching finance courses and was presumably an expert on the topic, so the idea of using whole life insurance as a strategy for financial success seemed odd. It went against what I had read in the finance textbooks. However, the truth was that I really did not know anything about whole life insurance or how it might be used. Thus, there was a learning curve for me to overcome. Nelson's book provides a very useful tool in speeding up that learning process and as others improve their ability to explain the strategy newcomers will be able to comprehend it and employ it far faster than I did.

LMR: You are an accomplished, self-published author. Do you think this is a growing field, threatening the traditional publishers? Any advice for young authors?

PC: One of the important realities that I've learned from my study of Austrian economics is that markets are dynamic and not static. This is important for two reasons. First, any successful entrepreneur should be able to know and define the market that he intends to enter before competing in it. Second, the successful entrepreneur should not expect that what works today will work tomorrow. Thus, I think you have to be vigilant and flexible. The latest change in publishing I think will be electronic publishing and I think this is already undercutting traditional publishers.

PEOPLE ARE VOLITIONAL and capable of understanding the world and acting in it. While many of the writers might not share my faith, they do share my understanding of human nature and that is the key.

Events and ENGAGEMENTS

2012

JULY 12-13 · LAS VEGAS, NEVADA

Murphy participating in FreedomFest panel with Laissez-Faire Books

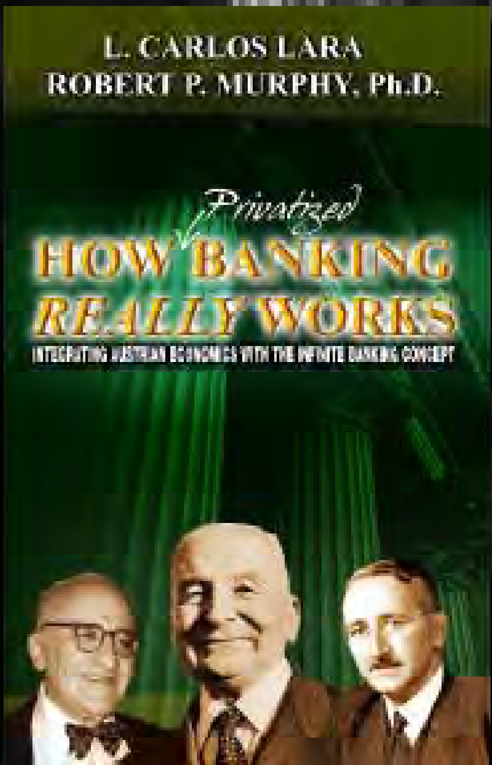
JULY 22-28 · AUBURN, ALABAMA

Murphy lecturing at Mises University

SEPTEMBER 19 · RANCHO SANTA FE, CA

Lara and Murphy presenting at “Day of Clarity” event hosted by Earl Eastman

Some events may be closed to general public.
For more information email LMRevents@usatrustonline.com



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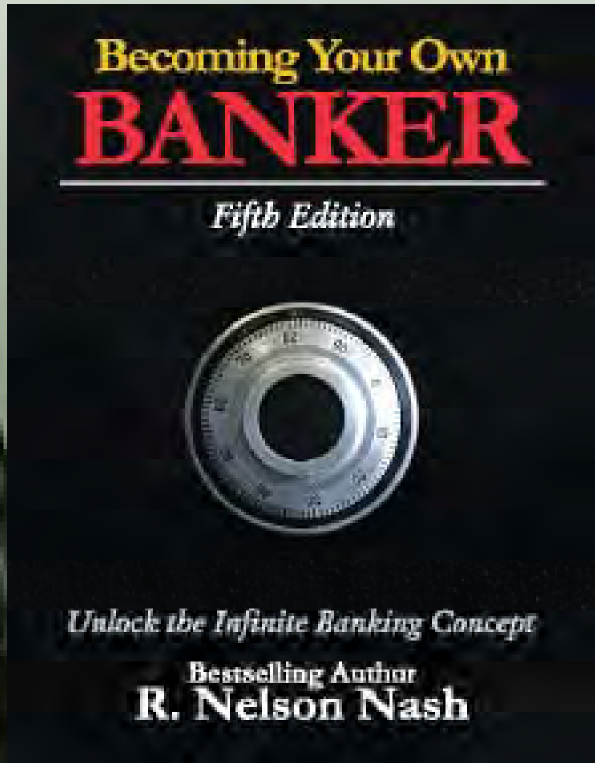

Fund Your Own Bailout.

If you don't like giving large sums of money to banks and mortgage companies to finance your cars, homes, boats, capital expenditures for business needs or any thing else you need to finance, then you are going to really like this alternative. The rebirth of ***Privatized Banking*** is underway. You can take advantage of the years of experience that these three authors in these two books are offering you. Go to: WWW.USATRUSTONLINE.COM click: STORE and look for both of these books among the other fine books.