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2957 Old Rocky Ridge Road
Birmingham, Alabama 35243

BankNotes archives:

infinitebanking.org/banknotes

Nelson Nash, Founder
rnnash31@gmail.com

David Stearns, Editor
david@infinitebanking.org

# How Mutual Insurance Holding Companies Really Work Part II - *Inside The Closed Block*

by L. Carlos Lara

[Reprinted from the December 2013 edition of the *Lara-Murphy-Report, LMR*]

We all know that long ago the Church condemned usury. As a result a special monetary device was conceived that allowed religious institutions to borrow great sums of money from the public without committing this sin. That peculiar financial instrument was the *annuity*. Its features worked so well that governments soon began using it too. In fact, in 1689, King Louis XIV of France used an annuity scheme devised by *Lorenzo Tonti*, a Neapolitan banker, to raise needed funds for the state. It was immensely successful and the plan was quite simple. Money was set aside yearly for the contributing participants. As participants died and their annuity obligation ceased, everlarger annuity amounts became available to the survivors. The longer one lived, the larger grewthe annuity payout. Two centuries later, Henry B. Hyde, President of the Equitable Life Assurance Society of the United States, revived the use of this "*tontine*"[1] concept and in doing so completely revolutionized the industry. This one apparatus made the life insurance companies in the United States the most powerful financial institutions in the world until the twentieth century when it was outlawed. In this article we will explore why, and what all this has to do with the "*closed block*" in a mutual insurance holding company (MIHC).

In this second section of a two-part ***LMR*** series on *How Mutual Insurance Holding Companies Really Work* we elaborate further on this unique mutual insurance hybrid, which has become the most sought after method to reorganize a mutual insurance company in modern times as opposed to simply demutualizing it. Since 1995, over 70% of insurance company mutual reorganizations have used the MIHC structure. As we explained in Part I, the impetus to reorganize in the first place was generated by the onset of the *Financial Services Modernization Act*.[2] This law eliminated many of the 20th century barriers that once separated banking, investments, and insurance. Once passed it unleashed a conglomeration of financial services giants seeking to merge or acquire one another. In the insurance sector, the larger mutuals now found themselves with a definite advantage to fully demutualize and many did. On the other hand, the smaller mutual was placed at a distinct disadvantage and became vulnerable to a take-over. The idea that the mutual may be going away permanently is startling to many, but the facts are clear: We now have only approximately 13 pure mutuals, down from 150 back in 1965. But it has actually been the MIHC form of reorganization that has stopped the complete evaporation by allowing a mutual company to be split into a tiered edifice containing both a mutual holding company and a stock company, while at the same time holding onto its cherished *mutuality*. One of the most significant factors in the MIHC structure is that 51% of the voting control of the downstream stock company remains (by statutory law) with the mutual holding company. This is where the policyholders maintain their ownership and membership rights. (SEE Diagram A.)[3]

**Mutuals in the United States**

For those of us that mourn the loss of so many of the mutuals it may be comforting to know that mutual insurance companies have always been few

**The Conversion Process: Diagram A**

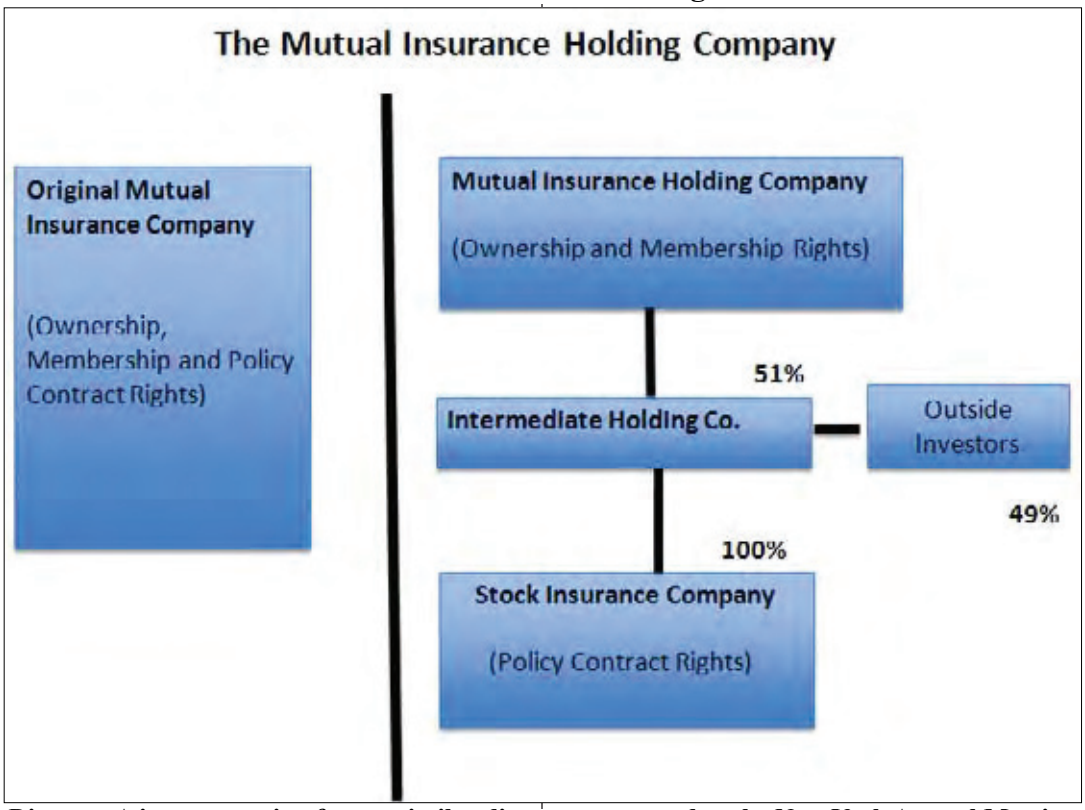


**Diagram A is a re-creation from a similar diagram presented at the New York Annual Meeting of the Society of Actuaries October 18-21, 1998, Panelist and Presenter, Carl M. Harris, Principal with Deloitte & Touche in Des Moines, Iowa.**

in number. In one very important sense the mutual was originally—more or less—forced into existence here in the United States. To fully understand why, we have to trace the early beginnings of the life insurance business in this country. Basically, it was illegal to launch the easier and more preferable stock company because there was a monopoly on corporate formation for insurers, granted by the English Crown in 1720.[4] This had a negative effect on the development of the insurance business in the American colonies, making it impossible for new entrants into the business to compete against the more established London stock insurers. The mutual concept was the only viable choice available.

The first life insurance corporation in the United States was a *mutual* established in 1759 in Philadelphia by the synod of the Presbyterian Church as the *Corporation for the Relief of the Poor and Distressed Presbyterian Ministers and for the Poor and the Distressed Widows and Children of Presbyterian Ministers*—known today by the shorter title—*The Presbyterian Ministers' Fund*.[5] Undergirding the establishment of this first life insurance organization by a religious group is the recognizable scripture verse taken from the New Testament, which says:

***"Religion that God our Father accepts as pure and faultless is this: to care for orphans and widows in their distress." — James 1:27***

Foundationally, the desire for security is one of the most potent motivating forces of human history. Early societies relied on families for this security, but with economic progress and growing financial sophistication, a more formalized and structured source of security is contractual insurance. For this universal reason, those who fully understand the nature of insurance tend to view it as a noble institution. The mutuals, because of their reliance on membership in order to form their infrastructure, best fit the description of a system of organized benefits.

**The Tontine Annuity**

The first stock proprietary corporate insurer in the United States was founded soon after the colonies won their independence from England; it was *The Insurance Company of North America* chartered in 1794. With the English monopoly on stock insurers having been broken, most of the new companies formed were stock companies. In the mid 1800s more mutuals emerged and gained in popularity with the advent of policy *dividends*. Then a New York State Law passed in 1849 (prompted by the more established mutuals) required a $100,000 security deposit for all new insurers. This would have been a substantial monetary barrier at that time so the numbers of new mutuals were contained, but it naturally paved the way for new stock company formations. From 1853 to 1865, 41 new stock insurers were organized. By then competition in the insurance business had grown fierce. Only 11 of those stock companies survived, but it was one of those survivors who brought back the centuries old "*tontine*" concept in 1868, as a marketing strategy to compete against the larger stock and established mutual companies. It worked beautifully, just as it had in the past for both religious institutions and governments. "Under tontine policies, premiums were split between ordinary insurance that paid a death benefit and a limited group investment fund that deferred dividend payments for a term of usually 10-20 years. At the end of the term, only the surviving participants received the *deferred dividend* proceeds as either a lump sum or an annuity."[6] The incentive to take part in this scheme was tremendous and demand for these types of policies soared. The emerging middle class, eager to get involved in investment options, poured huge amounts of money into life insurers who were amassing these large quantities of funds without the need for mandatory reserves. Insurance companies grew rich and powerful—more so than any other financial institution of that time.

**The 1905 Armstrong Investigations**

According to a recent CIPR study put out by the National Association of Insurance Commissioners dated August 2013, it was *tontine deposits* and the effects it had on the industry that eventually led to accusations of insurer mismanagement and corruption, culminating in the 1905 Armstrong Investigations held first in New York and later in many other parts of the country. The report goes on to state that prior to this investigation insurers were using these large amounts of money to buy controlling shares in banks and other corporations. They participated in investment syndicates to buy bonds at cheaper prices, underwrote securities, sat on the boards of banks, and influenced politics. The Armstrong Investigation was mostly concerned that insurers had grown to such proportions that their failure would wreck havoc on the economy. Most of the criticism for financial misbehavior was centered on the stock companies, which ultimately lost substantial market share. "*As a result, three of the then largest U.S. stock insurers—The Equitable, The Metropolitan and the Prudential—converted to the mutual form of insurance thereafter*."[7]

The aftermath of the Armstrong Investigations were sweeping. States assumed much broader and more comprehensive regulatory control of the industry from that point forward that still remains in place today. Dividends, for example, were required to be paid annually ending forever the "*deferred dividends*" of the tontine system. Additionally, insurers were prohibited from owning common stock and underwriting securities. So even before the enactment of the *Glass Stegall Act of 1933* that came down hard on commercial banks for the same type of financial misdeeds, insurance companies were prohibited from co-mingling with banks and investments firms 28 years earlier. During the "Roaring '20s" and before the onset of the Great Depression, the life insurance industry had completely rebounded financially with new all-time sales records. With investor confidence in insurance restored and the industry completely detached from stock market investments, the Crash of 1929 did not have the same devastating impact on insurance companies as it did on banks and investment firms. Only 20 of the 350 insurance carriers in operation, or about 5%, went into receivership. Even so, reinsurers honored all policyholder claims. Banks, on the other hand, had over 4,000 failures out of 25,000 banks, or a 15.5% failure rate, with a loss to depositors of $1.3 billion.

In spite of this glowing episode in favor of the life insurance companies, the industry did not escape unscathed. The Great Depression wore on for years, generating mortgage defaults and policy surrenders that drained cash flows. (Insurance companies were partially invested in mortgages.) A low interest rate environment very similar to that of our own current times hurt both asset valuations and earnings. Credit ratings also suffered and caused insurers to shift their investment strategies to deal with the economic environment of the times. This is, of course, a historical portrayal of the profound effects of a classic boom-bust cycle, as Austrians would depict it.

**The "Closed Block," Its Significance, and the Future**

Following enactment of the *Financial Services and Modernization Act of 1999*, mutual management had to make drastic changes, once again, in its governing strategy in order to align with the new economic environment. For many of them this meant demutualization. For those that chose the mutual holding company route a different sort of challenge lay in store. The process is rigorous and expensive although not as much as that of a complete demutualization. One example of the technical processes of forming a mutual holding company is the need for on-going separate accounting of the "*closed block*"[8] that has to be reviewed annually. To fully understand this requirement, we have to keep in mind that the pure mutual is changing over to a stock company. In order to be fair and equitable to the policyholders of the pure mutual that is going away, an initial separation must take place since no cash or shares of stock were distributed as compensation as in the normal process of a complete demutualization. Therefore, the closed block insures the mutual policyholders of their future dividends and is like a giant box you open and throw in all of your (participating) dividend-paying policies along with all of the matching assets required to fully mature that business—then you close it permanently. In other words, it is like walling off the liabilities and assets for that entire block of business and never reopening it again for as long as possibly 100 years. What goes in the box at the time of the reorganization stays in there. It is especially noteworthy that if by chance the closed block performs better than anticipated (a very real possibility since those assets are probably paying 8 and 10% interest), then the money cannot revert to the company or shareholders in case of an IPO. At the same time any stored-up surpluses can create, if management is not careful, a huge "*deferred dividend liability*"[9] or what we have already learned is an illegal *tontine*. Since the closed block is a *closed system* and if such an accumulation of dividends were allowed to happen, then we could say that if everyone's policy lapsed inside the closed block with the exception of yours—you would win the lottery! So of course, those surpluses must be carefully managed, accounted for, and distributed over time to the mutual policyholders to prevent that from happening.

The additional good news is that the MIHC structure is set up to be a self-perpetuating system. Initially, all of the policyholders of the pure mutual at transformation are deemed to be also members of the new mutual holding company (MHC). After the transformation, policies issued out of the stock insurance company will also become members of the MHC to avoid the tontine effect. The policies inside the closed block will eventually leave the box whether it's in 80, 90 or 100 years, leaving only the policyholders of the stock company who each have membership rights in the MHC, and (by law) must always own 51% of the stock company.

If the MIHC ever wants to fully demutualize, the policyholders as members have a say in that decision and can expect to be compensated accordingly for their membership interest. If the MIHC wants to issue an IPO, policyholders have the option for first rights to subscriptions of such an offering. So in effect, policyholders in a MIHC—as in a pure mutual—are not simply owners of a financial product as in a pure insurance stock company, but also actual owner/members of the entire financial structure.

**Conclusion**

In light of all these changes one thing can be said for certain: Mutual management can no longer think in

terms of a 20- or 30-year horizon. Stock management, the type found in the MIHC, is now forced to think every time the stock market ticks, central bankers tinker with interest rates, or whenever massive amounts of money are moved through our banking systems. This could be a huge disadvantage since insurance by nature is a long-term business. On the other hand, it could be the best thing that could have happened to the industry. The history of life insurers demonstrates that in spite of changing economic times, its reason for being has never been ignored. Its most important element is providing either total or partial relief from the potential burden of financial loss, commonly known as the transfer of risk. In order to hang on to this important feature, which encompasses the very heart of the life insurance business, insurers have always been ready to try, fail, and try again to maintain their market share.

In the wake of the 2008 financial crisis, all of the players in the insurance sector—as all other sectors of our economy and of the world at large—are being forced to evaluate their possible options in navigating the uncertainty of our interconnected, yet fragile financial systems. The challenge is great for these are exceptional times.

This two-part exposé has been written solely for educational purposes. It is directed in particular to my fellow Infinite Banking Concept (IBC) Practitioners, who utilize the insurance sector in our personal lives and in our work. As far as a plan of action in light of present circumstances and especially with regards to mutuals and mutual holding companies, our message remains the same. It does not change. Like all those who are properly schooled in Austrian economics, we—the Authorized IBC Practitioners—of all people are in the best position to stand back and see all this for what it means. Our current economic environment should not surprise us. We predicted it. What Nelson Nash wrote in his book, *Becoming Your Own Banker*, and what Robert Murphy and I wrote in ours, *How Privatized Banking Really Works*, is still true and foundational—every word of it. Teaching Austrian economics to the public while continuing to implement IBC actually helps people immediately and gets us closer to our 10% mark of helping all of society. For this reason we must never stop.

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# Do You Know Who the Swiss President Is?

by Bill Wirtz

Doris Leuthard. That's the name of the incumbent Swiss president in case you wondered or might need it in a general knowledge quiz any time soon. But how come a country this well known on the international stage happens to have such an unknown executive?

**The Swiss Opposed Centralization from the Start**

The beginning of the Swiss confederacy wasn't about power.

From the 14th century on, while Europe was torn in territorial conflicts or the religious Thirty Years War

of 1618 to 1648, the (originally) 8 cantons of the Old Swiss Confederacy were a microcosm of peace and prosperity. These cantons in themselves did have religious differences, but preferred to agree on a pact of mutual military assistance to protect the neutrality of the region and its peace. The Holy Roman Empire had granted this community of cantons imperial immediacy, meaning they were declared free from its rule while being a part of it. As the European royalties raised massive amounts of taxes to finance their decade-long wars, being Swiss was comparable to living in the first true tax haven: by any means the destruction in all of Europe made the differences that these cantons have look insignificant.

Later, religious differences in Switzerland grew, sparkling battles between Catholic and Protestant cantons. Each of these battles had winners, yet none were able to impose a true change of regime, as the cantons were too diverse to be governable. The cantonal governments refused to cooperate with each other: the only foreign policy they could agree on was that of neutrality, which ended up saving it from war.

The French Revolutionary army invaded the Confederacy in 1798 and established the Helvetic Republic, a centralized state, abolished cantonal sovereignty and feudal rights and reduced the cantons to administrative districts, all in the image of France itself. This French nation-building project failed 5 years later, as the population didn't cooperate with any centralization attempts. The Helvetic Republic was incompatible with the Swiss mentality: the people demanded that government decisions be made at the canton level, not at the federal level.

**Centralization and Switzerland's Civil War**

After decades of struggles over the centralization of power, a civil war ended the everlasting Swiss question of the legitimacy of a federal government. The Sonderbund War started in 1847 and was a fight between seven conservative and Catholic cantons who opposed the centralization of power and rebelled against the Confederation which had been in place since 1814. What followed was probably one of the least spectacular wars in world history: the federal army had lost 78 men and had 260 wounded. The Sonderbund conspiracy dissolved and Switzerland became the state it is today in 1848.

Think about this, the Swiss fight (which was marked by its incredible lack of violence in comparison to others) was purely over the rejection of the centralization of power, the skepticism of the responsibilities that a large entity has, while, mind you, we're only talking about a country of 16,000 square miles. The result is a relatively neutral state which maintains a greater amount of freedom and prosperity than most European nations.

**The Federal Council, Impotent by Design**

The executive of the federal multi-party directorial republic is a body called the Federal Council. It is composed of 7 members (each one responsible for one of the seven departments in Switzerland) who are voted into their position by both chambers of the Federal Assembly. Their presidency and vice-presidency is rotating each year, their mandate is four years. The current council is composed of 2 social democrats, 2 center-right conservatives, 2 national conservatives, and one Christian-democrat (Doris Leuthard, who's the current president).

While the Confederation of Switzerland was designed to follow the example of the United States when it comes to federalism and states' rights, the Swiss avoided the concentration of the executive into one person. It is interesting to note that although every European country made (and makes) constant changes to their form of government, this council has not changed since 1848. The only political change has been made to the Federal Council, is the reversal of the Magic Formula, or also known as the Swiss consensus, a political custom which divided the 7 seats in the country between the four ruling parties. With the arrival of billionaire industrialist and EU-opponent Christoph Blocher and his Swiss People's Party, this political agreement had been shaken up and, furthermore, made Switzerland's accession to the European Union more and more unlikely.

The council shows unity towards to the public and most decisions are made by consensus. That is

largely because their function is more decorative than functional, as most of the power is still held by the cantons. Decisions related to education and even levying taxes are made at the regional level. There is no executive action or veto which the federal government could use.

The president of Switzerland has little to no room in public political discourse. So if you don't know who the new president of Switzerland is, don't worry. Some Swiss people might not know either.

**Localism Works in Switzerland**

The Swiss cantons perform the balancing act of politics: the conservative cantons are those outside of the big cities such as Zurich, Geneva or Bern (the capital). The population in the smaller communities reject the tendency to govern from the capital. As a result, the Swiss have continuously rejected proposals like the ones phasing out nuclear energy.

This push for localism would be considerably more difficult if it wasn't for the system of direct democracy that is very common in the Confederacy.

All federal laws are subject to a three to four step process:

1. A first draft is prepared by experts in the federal administration.
2. This draft is presented to a large number of people in an opinion poll: cantonal governments, political parties as well as many NGO's and associations out of civil society may comment on the draft and propose changes.
3. The result is presented to dedicated parliamentary commissions of both chambers of the federal parliament, discussed in detail behind closed doors and finally debated in public sessions of both chambers of parliament.
4. The electorate has a veto-right on laws: If anybody is able to find 50,000 citizens who will sign a form demanding a referendum within 3 months, a referendum must be held. In order to pass a referendum, laws need only be supported by a majority of the national electorate, not a majority of cantons. It's not unusual for Switzerland to have referenda on more than a dozen laws in any given year.

These referenda are the reason why the political majorities have decided to include their own opposition in government: if the majority does not seek a consensus, the oppositions can use a citizens initiative (referendum) to overturn any decision made on the national level.

The system of checks and balances through both the aggressively localist cantons and the tool of direct democracy has made Switzerland particularly resistant to the growth of government, and one of the few relatively liberty-minded bastions in Europe.

Bill Wirtz studies French Law at the University of Lorraine in Nancy, France.

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*Comment by R. Nelson Nash — Now that you have read this article I urge you to get a copy of Restoring AMERICA One County at a Time. Joel McDurmon does a great job of showing where and when our country went wrong by adopting the idea of centralized government and centralized planning. Thomas Jefferson conceived of a government that would be very similar to what is described in this book and is exemplified by what we see in Switzerland today. But, Jefferson went to France as Ambassador shortly after our secession from England. When he returned some years later he was startled that, under the influence of Alexander Hamilton, we had reverted to the British idea of Mercantilism —but this time on steroids! Our constitution made possible the nonsense that is going on in our country today. There are many books on our Book Recommendations tab on our website. Please study them!*

# How Central Bankers See Themselves

by C. Jay Engel

ECB Executive Board member Peter Praet recently gave a speech in Brussels. The underlying theme

captures the convenient positioning of world central banks. They want to be seen as saviors of collapsing financial markets, but neither the cause of the instability nor the continued struggle for economic growth. From the speech:

> Faced with a prolonged crisis, the ECB's unconventional policy measures have been essential to provide additional accommodation to the economy and prevent a self-sustaining fall in inflation — and they have been a clear success. Easier credit conditions have fed into a domestic demand-led recovery that has spread across countries and sectors. The economic outlook today is now better than it has been for many years.

And yet, as he admits, the ECB has been in crisis mode since 2008. So they want appreciation for bringing forth recovery, but want the world to look elsewhere for the reason why these economies aren't self-sustainable. He even blames the crisis in the first place, not on central bank activity from 2000–2007 but on the masses themselves!

> The first [cause of the crisis] was the bout of over-optimistic expectations which took hold in several advanced economies in the pre-crisis years, reinforced in the euro area by a renewed sense of security and economic prosperity following the launch of monetary union. Despite slowing potential growth, agents in a number of economies overestimated their future income and borrowed against it, accumulating excessive debt. In some countries this over-leveraging was centred [sic] on firms, in other countries on households and in others still on the state.

Well, one might ask where this "excessive debt" came from. Does it not come from central bank policy? What Harry Browne once noted of governments equally applies to central banks: "Government is good at one thing: It knows how to break your legs, hand you a crutch, and say, 'See, if it weren't for the government, you wouldn't be able to walk.'"

One of the consequences of living in an unfree world is the aggravating subjection to condescending Official Narratives. It's not just that our Monetary Saviors get to make money supply and interest rates decisions on our behalf, it's also that we are being saved from our own over exuberant actions. We ruin the economy, and then we get pulled from our own fires. And the bureaucrats hardly get a thank you!

Now, unfortunately, the end of their blessed interventionism is not on the horizon. Praet expresses with disapproval that inflation rates are still too low:

> Given the softness of underlying inflation, however, we cannot yet be sufficiently confident that inflation will converge to levels consistent with our aim in a durable manner. Inflation dynamics also remain reliant on the present, very substantial degree of monetary accommodation, so they have not yet become self-sustained.

Indeed, because what we all hope for is a sustainable trend of rising costs for goods and services. This is what keeps the central bankers up at night. Central bankers are not yet satisfied with what they've done to us. And so they march on. What would we do without them?

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

Comment by R. Nelson Nash — Central Bankers are masters at the art of "playing god." When you look up the meaning of the word hubris I believe you might possibly see a picture of Central Bankers!!!

## America Is Hardly a Bastion of Free Trade

by Andrew N. Smith

Rhetoric has recently trumped reality. It has become a misconceived bit of common "knowledge" that the United States of America is a bastion of free trade. Little could be further from the truth. The "freest" nation on earth, as we are taught to believe, imposes a staggering number of tariffs, import and export bans, sanctions and embargoes. Yet somehow "free trade" is blamed for the financial ills of the unemployed in the formerly industrial Midwest. Instead of taking a

serious look at our existing trade policies, and maybe reducing some of the regulations, President Trump promised Midwesterners that their inefficient factor jobs that have been outsourced to the "right to work" south and overseas will be brought back by imposing new import taxes on specific companies. It is a naïve and ignorant notion that singling out countries and taxing the goods they import into the US will somehow help the unemployed while having absolutely no effect on the country's general productivity and standard of living. Besides, we've already been doing that for far too long.

The US imposes tariffs on over 12,000 different goods and services. No that is not a typo — *over 12,000*. Some of these tariffs are so significantly prohibitive that they are effectively outright bans. Sugar, for example, is one product that Americans get gouged on, paying an average of $277 million more per year than they should. That is $277 million *per year* that would otherwise be used to consume other goods, invested in growing businesses, creating jobs, and raising real wages. This is nothing new. The original tariff was imposed as a "temporary" protection for US sugar farmers, that was more than 80 years ago. It has protected US sugar farmers, but has also decreased the productivity of the sugar farmers' land. The laws of absolute and comparative advantage would dictate that the land on which sugar cane and sugar beets are grown and harvested should be used to produce goods in which these particular regions can more (cost and time) efficiently produce.

Sugar is not the only good, not by a long shot. Even America's favorite snack while watching America's "favorite" past time — peanuts — are significantly more expensive than they otherwise would be because of measures to "protect" the US peanut farming industry. Specifically, the government imposes a 131.8 percent ad valorem tax on shelled nuts, even higher tariffs are applied to unshelled peanuts. The peanut farming industry is a $1 billion industry, annually. The question is how much are those numbers padded by the tariff, and how much less would consumers be paying for peanuts if peanut farmers weren't a privileged class. A further example that demonstrates how inefficient these tariffs are is the import tax and quotas placed on rubber tires. In 2012, President Obama bragged about creating "over" 1,000 jobs in the tire manufacturing industry resulting from the measure. One account estimates that in 2011 alone Americans paid an additional $1.1 billion for tires, or roughly $900,000 per "job created," than they otherwise would have. The same estimation concludes that 2 retail jobs were lost for every 1 manufacturing job created by the tax. Tariffs are not the only way that the US government engages in what many would call "fair trade" instead of flat out free trade. Embargoes placed on several countries for so-called diplomatic purposes also distort international trade. Worse than the distortions they create, they don't work for diplomatic advancement either. History tells us — and as 19th century classical liberal Otto T. Mallery (and many others before and since) did — when goods don't cross borders armies do. Contrary to popular belief it was not the European Union being created, it was not the United Nations mandating a beach bonfire kumbayah between countries, and it wasn't the US military presence around the globe that has prevented another World War. It has been the increasingly open global market, the economic entanglements and the consequential benefits that nations reap when trading with others.

Before "heaping absurdity upon absurdity" as Bastiat put it in his famous essay *The Petition of the Candlestick Makers* maybe first we should take a look at the existing pile of absurdity that is US trade policy. To be clear, trade policies can carry many nuances. Tariffs don't always necessarily only effect price, they could quite possibly effect profit margins of overseas corporations and create employment. They do always necessarily reduce prosperity. Even in the event that new jobs are created, they are likely to be less efficient jobs — either in cost, time or both — than their overseas counterparts. The best way to increase the number of jobs and the wages paid to those jobs is to increase the productivity of industry. First steps toward that should consist of tax reform, regulatory reduction, encouraging capital formation and accumulation, and repatriating the trillions of dollars stashed offshore as a result of high taxes and

burdensome regulations. Imposing *more* tariffs on *more* goods and *more* countries will simply make America a less productive society. Instead we are far better off focusing on producing the goods and services that — as the law of comparative advantage dictates — we are *most* superior at producing.

*Comment by R. Nelson Nash — "The United States of America is a bastion of free trade." What a joke! But, Goebbels was credited with saying 'Say something long and loud enough and people will come to believe it is true."*

## Selling Higher Education Is Sleazier Than Selling a Used Car

by Jay Stooksberry

In a previous life, I worked in sales. But not just your everyday, run-of-the-mill brand of sales: I worked in a sleazy industry that championed predatory lending practices and distorted the pricing of its lackluster product, which often sent my clients spiraling down a rabbit hole of debt. And to make matters worse, this entire enterprise was buoyed by your tax dollars, so—regardless of macroeconomic patterns—this dubious marketplace remains untouchable.

What was this ethically questionable industry? I worked in higher education.

More specifically, I worked in college admissions and financial aid. Many of my former admissions colleagues and peers—all of whom I consider to be good friends—probably take offense to how I characterized their livelihood, but I would have too back in the day, when I was in the thick of it.

I took my pride in my work, but it was taxing (pun unintended). I spent nearly one-fourth of my year on the road—living in hotels, visiting high schools, attending college fairs, and pitching my school as the place to be for unsuspecting 17-year-olds.

The gig was not only physically exhausting, but also morally. What once seemed like an altruistic mission—helping the young people of today become the leaders of tomorrow—transformed into a much more realpolitik mindset. Slowly, I realized my job wasn't to empower young people, but to get them and their parents to commit to paying a very large sum of money—either by cash or credit—for a little piece of paper that continues to diminish in value.

I always considered myself to be on the up-and-up with the families with whom I worked. I never lied to my students or their families. I always represented my institution truthfully. I always worked hard to get them the most "bang for their buck."

However, it didn't matter how ethical I behaved as an admissions counselor; the entire system is broken. Moral hazard has run amok in the college system.

After a few years, I came to the unfortunate realization that I was no better than a car salesman.

What follows are just a few reasons why car lots behave more ethically than colleges and universities.

**Markups**

The markup on college tuition is astronomically higher than the markup on a car.

Product pricing always comes with a little fudge room. Many refer to it as markup. This is just a given in the world of sales and retail. That wiggle room allows sales reps the ability to offer "one time deals," which serve as an effective call-to-action when closing the deal.

In the higher-ed world, we refer to this wiggle room as "discounting." Discounting is the act of advertising an astonishingly high rate of tuition, then bargaining with scholarships, grants, loans, and other forms of financial aid until the buyer finds a less painful price point that is still astonishingly high, but still lower than before.

Sticker shock is a very real thing in the college admissions gig. During my tenure in higher education, annual tuition at my college was roughly $30,000 per year. But it didn't stop there: cost of living also included $4,000 for room, $4,000 for board, $750 for books, and $2,500 for other residual expenses (insurance, vehicle maintenance, etc.) that families should include in their annual budget. When it was

all said and done, that annual amount exceeded the $40,000 waterline—and this was only for one year.

Plus, to make matters worse, tuition always rises as if it is Newton's lesser-known "fourth law" of motion. On average, colleges jack up tuition roughly 5 percent per year. The board of trustees at my college, for example, was committed to "generous increases" that didn't exceed two percent.

"But don't worry," I told parents. "Nobody ever pays the full price." The discount rate varied for each student, but it was easy to cut tuition in half through discounting so that it didn't seem as bad.

A car dealer's markup is roughly five percent above the manufacturer's suggested retail price (MSRP). For my college, that markup was 115 percent! Sadly, this markup is average across all of the higher-ed industry.

My college was not unique in this up-charge. The institutional discount rate is universal in the higher-ed world and has steadily increased nationwide. A 2015-2016 report by the National Association of College and University Business Officers (NACUBO) estimated that institutional discount rates peaked at 48.6 percent that year—a trend they deemed to be "not sustainable."

While some schools rely upon hefty endowments, the majority of schools are classified as "tuition-driven." The same NACUBO study reported that only 10.8 percent of institutional grants were funded by endowments in 2015-2016. This means that the dollars received from incoming students are then recycled as scholarships for future students.

American higher education is caught in a vicious cycle of robbing Sophomore Peter to pay Freshmen Paul. But most families feel like they are getting the deal of the century thanks to tuition discounting.

**"Discounts"**

Car dealerships don't require a tax return to determine how much to charge you for that car.

The discount rate is the result of the backward math that takes place during financial aid season.

All families seeking financial aid must first complete a Free Application for Federal Student Aid, also known as the "FAFSA." Hopefully, the irony of the word "free" isn't lost on everybody.

For those who have not had the "pleasure" of applying for financial aid, consider it the equivalent of filling out your tax return— again. The FAFSA requires a detailed accounting of a family's financial situation before any financial aid is allocated.

Once a FAFSA is completed, a family's estimated family contribution (EFC) is determined. This is the end result of a convoluted algorithm that determines a family's ability to pay for college. Colleges and universities subtract the EFC from the cost of attendance (tuition, room, board, books, etc.) to determine "need."

As many families will attest, the EFC overestimates a family's ability to pay for college. It is a one-size-fits-all metric that does not take into account regional cost of living, utilized outdated budgeting estimates, makes many illogical assumptions, and ignores situational expenses (for example, large medical bills). There are some means to appeal and adjust mitigating circumstances, but it does little shave points off the EFC.

But name any other product or service that evaluates your ability to pay before setting a price. You would hard-pressed to find other examples that don't involve market distortions created by government intrusion (e.g., healthcare, etc.), which conveniently brings us to the next point.

**Bailouts**

The auto industry was only bailed out once; higher-ed makes it an annual tradition.

Even one bailout is too much, in my opinion. The auto industry was on the receiving end of a $79.7 billion handout, following the financial crisis of 2008. Though monies were paid back, the Congressional Budget Office estimates that the program still cost taxpayers roughly $14 billion.

Meanwhile, the postsecondary market is bailed out every single year. In 2014 alone, $133.8 billion in federal dollars were allocated to over 5,000

postsecondary institutions to be used as financial aid.

This aid, however, doesn't come in the form of a federal check made out to a needy student. Colleges and universities are the beneficiaries of these funds. Once enrollment counts for the upcoming year are finalized, funds are issued to the colleges who then, in turn, manage how they are distributed.

And this annual bailout is fueling rising costs. Studies have found that federal funding directly contributes to inflated tuition pricing.

The Federal Reserve Bank of New York found that every dollar awarded by Pell Grants resulted in a 55-cent increase in the "sticker price" of college tuition for students. Anecdotally, the board of trustees at my school waited for Pell Grant amounts to be set before they officially set our school's tuition rate. This residual effect, in conjunction with federal student aid, has continued to inflate the price of tuition year after year.

Throwing more public money toward higher education has created an opposite effect on the affordability of college. According to inflation-adjusted figures, public investment in higher education is ten times higher now than it was in 1960. For perspective, military spending is only 1.8 times higher. Meanwhile, college tuition is 1,120 percent higher during roughly the same time period.

Consider the practice of federal financial aid as the equivalent of TARP, the auto bailout, another form of corporate welfare doled out to "too large to fail" institutions, who demand that taxpayers foot the bill for their failing business models.

**Potential Bubble?**

Interestingly enough, total debt issued for both industries is comparable. There is about $1.2 trillion of student loan debt and about $1 trillion in auto loan debt.

Speculation of a possible auto loan bubble has surfaced as delinquency rates started to spike—specifically in the subprime markets that target borrowers with bad credit ratings or minimal collateral. Default rates for these risky loans were highest—14.4 percent—in 2014.

Meanwhile, what was the rate of default for student loans in 2014? Again, it was a comparable at a rate of 13.7 percent.

But that student loan debt bubble may be intensifying. According to The Wall Street Journal, "43% of the roughly 22 million Americans with federal student loans weren't making payments" as of January 2016. Furthermore, 3.6 million borrowers were in default on $56 billion in student debt.

What makes student debt troubling is the utter lack of underwriting. College-seeking families can borrow tens of thousands of dollars with virtually no due diligence performed by the lender (e.g., the federal government playing loose and fast with your money).

There is no consideration of the applicant's ability to repay the loan, so it's quite easy for a student to finance a degree with low market value. There is no risk assessment of an applicant's potential for default, all while student loans traditionally have a higher default rate in comparison to mortgages.

There is no collateral requirement, so loans are not secured and recipients invest nothing up front. Also, recipients aren't required to make payments until after they have completed their degree or drop below half-time status, so returns on investment are slow to trickle back.

On top of all of this, it is virtually impossible to discharge your student loans if you file for bankruptcy. Even with all of this, student loans have managed to escape the label of "predatory lending."

Even if the bubble were to burst, think about who owns the paper on all that debt? Keep in mind that the colleges and universities already got paid. Everybody else—namely, taxpayers—will foot this bill if things went south. Those paying both income taxes and student loans are already double dipping into this postsecondary Ponzi scheme.

**No End in Sight**

If you have spent any amount of time on a college campus recently, you have witnessed firsthand how

lavish the "college experience" has become: multi-million dollar educational facilities, picturesque landscaping, posh residential suites, athletic training facilities fit for Olympians, nationally-televised sports programs (which, by and large, drain funds from educational programs), and a reserve army of administrators who have nothing to do with education whatsoever.

As one of those enlisted and overpriced "pencil-pushers," I feared that one day, the parents and students with whom I worked would realize how sleazy the whole enterprise was.

But that day never came. Instead, most people seemed pleased with my work, despite inspiring them to take out a second mortgage to fill my university's coffers.

Obviously, society at large ascribes a high degree of value to higher education, granting immunity for some various obvious—and often times startling—shortcomings. Imagine a congregation of churchgoers, who overlook the sins of their womanizing, alcoholic, and BMW-driving pastor because of his vaunted position. "We know he is troubled," the congregation rebuts. "But he has done so much for the community."

If you couldn't tell, my job left me feeling sleazy at times.

All feelings of altruism that I once felt when I was first hired were out the window after a year or so. And those feelings were replaced with dystopian thoughts about what it would take for higher education to reverse course.

During college fairs, I often daydreamed about the perfect circle necessary to topple the higher education cartel. The only thing that made sense was abolishing the Department of Education and cutting off the ever-so-generous allowance that taxpayers have doled out for nearly a half-century.

The task of reforming higher education is Herculean in scope—much bigger than the load little jaded admissions counselor me could tackle. The best thing I could do was look for a more ethical line of work, which I did. And, no, I didn't end up selling cars.

Jay Stooksberry is a freelance writer with passions for liberty, skepticism, fatherhood, humor, and whiskey. His work has been published in Newsweek, Independent Voter Network, Fatherly, and other publications. When he's not writing, he splits his time between marketing consultation, outreach work for his local Libertarian Party affiliate, and enjoying his spare time with his wife and son. Follow him on Facebook and Twitter.

*Comment by R.Nelson Nash — I Can't comment on Jay's article. He did the perfect job with the subject. For me to say anything more would be to mess it up. Thanks Jay!*

# Freedom Is Essential For True Morality

by Alex Salter

What is the role of human freedom in morality? It's a question I've been pondering and researching since graduate school.

C.S. Lewis once explained the different aspects of morality by using the metaphor of a flotilla. Every ship must be well run on its own, but each must also coordinate with all the others so that they avoid collisions and stay in formation. Finally, the fleet must be set on a destination, which constitutes the purpose of their journey. This is a helpful way to think about morality regarding self, others, and our ultimate end.

**Personal Morality**

The personal aspect of morality—which might more properly be called ethics—is about the cultivation of virtue: the development of character traits so that choosing the good becomes a matter of habit.

An efficient and well-run ship is like a virtuous person: both have regularized the internal practices necessary to be a good example of what it is. There is one crucial difference, however: a ship's crew is run hierarchically, under the command of a captain. But a person, in order to be truly virtuous, must be free to cultivate the virtues, or not.

There is no virtue in being temperate when you are being forced not to indulge. There is no virtue in

being charitable when someone is forcing you to give up what is yours. Virtue can be guided by cultural traditions and social institutions, but it cannot be coerced. A virtuous man must also be a free man.

**Morality Regarding Others**

The *inter*personal aspect of morality is more about rule following. These rules are important because, like the rules governing ships in a fleet, they prevent us from "colliding" with each other. They permit us to live together in harmony, and they also make us recognize, apart from the mere consequences to ourselves, the rights of others. Here too, liberty is essential.

When some people are permitted to dominate others, they treat others as merely a means to an end, rather than ends in themselves. Not only does this fail to honor the basic dignity within each person, it also stifles the flourishing of human potential and creativity. A society of domination will be a society that never reaches its full potential in the human sciences, physical sciences, and creative arts. Liberty affords us the greatest space possible to pursue our projects, in a way that enables us to live well with one another.

**The Big Questions**

Finally, there is the question of ultimate ends. Why are we all here? Where are we going? This will necessarily be the most contentious since the idea of a final end for man often goes in tandem with a specifically religious view of man's vocation. As a Christian, this is the position I hold.

But having a final end does not obviate the need for liberty. Freedom remains essential. To paraphrase Lord Acton, freedom is so precious that God will not override it, even when we badly misuse that freedom. In other words, we can't get where we're going if we're not free to walk the road. I think this is a point on which religious, spiritual, agnostic, or even atheist persons can agree.

Thus, freedom is essential to a genuinely good human life at all the levels of morality. In my view, the classical liberal tradition remains the keeper of the flame of liberty, and I want to spend the rest of my career advancing classical liberalism as a research program. I look forward to sharing with you what I find. Reprinted from *Learn Liberty*.

Alexander William Salter is an Assistant Professor of Economics in the Rawls College of Business, and the Comparative Economics Research Fellow at the Free Market Institute, both at Texas Tech University.

*Comment by R. Nelson Nash — Americans are not taught to value FREEDOM, They prefer to be granted LICENSE to do whatever they desire in life. And that grantor is the one they worship — their government!*

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# VISION

By Leonard E. Read

*Note - Frequent readers of BANKNOTES are aware of my relationship with Leonard E. Read and my admiration for his works during his lifetime. In the following issues I will be sharing his book, VISION, one chapter per month. It was written in 1978. What a privilege it was for me to know this great man!* – R. Nelson Nash

**Chapter 22**

**IS THERE TIME ENOUGH?**

*There is nothing covered that shall not be revealed; and hid that shall not be known.*
**-Matthew 10:26**

In a spirit of eternal vigilance, let's consider the important matter of advancing an understanding and practice of freedom.

As Aristotle observed, "One may go wrong in many different ways, but right only in one." This applies as pertinently to the subject here at issue as to any other attainment.

First, what are the wrong ways? They are too numerous to list; so to avoid misunderstanding, or pages of explanation, or offense to many of those devoted tofreedom, here is the one right way—as I see it: *self-improvement!* This means not only advancing one's own understanding of the freedom philosophy, but

achieving an ever improving clarity in explanation. This is the right way. All the others are wrong and, in my judgment, do more harm than good.

Why is self-improvement the right way? Truth, as related to freedom or to any other subject, cannot be cannonballed into the masses or into any single person. All good and elevating ideas, be they yours or mine or anyone else's, must be sought to be received. Real intellectual gains are made only in response to the law of attraction. In no instance can they be thrust into the mentality of another. All thrusting attempts are distractive rather than attractive and only magnify our problem. They cause the socialistic non sense to gain by leaps and bounds!

During FEE's 31 years we have heard over and over again words to this effect:

> I agree that self-improvement is highly desirable, but we are facing disaster and your remedy is far too slow. *Time is running out*. We must get our ideas into the heads of these ignoramuses-and quick!

Most, if not all, of the wrong ways for replacing a growing socialism with a longed-for freedom stem from the notion that there is not time enough for the right way.

Really, the appropriate question is not, "Is there time enough?" but, rather, "Am I enough of an exemplar?" Time is infinite, but I am finite. Thus, when it comes to improving the practice of freedom, my part is to improve myself in my time. Beyond that, there is nothing I can do about it.

If we review the history and timing of good movements, we find that Christianity did not exert its elevating influence on Western Civilization prior to Christ's crucifixion—and not, indeed, for many years thereafter. His exemplarity bore its wonderful fruit long after that shameful event.

Suppose He had held the idea that there wasn't time enough for purity of thought and simple righteousness to result in the conversion of great numbers and had resorted to the wholesale reformation of others during His earthly moments. There would have been no Perfect Exemplar and no Christianity today or ever!

In the realm of mortals also may be found exemplars of the kind that you and I should try our best to emulate—Frederic Bastiat, for instance. Did his wisdom cause a turnabout in his native France during his lifetime (1801- 1850)? If anything, the practice of freedom slumped during that period.

Bastiat, however, counselled two Englishmen—Richard Cobden and John Bright—who, in turn, were largely reponsible for the advance of the Industrial Revolution as governmental protectionism gave way to free trade-an unprecedented increase of goods and services to the masses. And this, also: at least a million Americans have read one or more of his works during the past 25 years—a contribution to our restoration of freedom more than a century after his death. Bastiat did not live to witness the fruits of his politico-economic enlightenment. Instead, he labored on his own improvement in his own time and, in the process, left intellectual guidelines for others to follow.

Assess the works of our Founding Fathers, writers of the Declaration of Independence, the Constitution and the Bill of Rights. These few were inner-directed, seeking an im provement in their own thinking and in their time. Few if any of them lived to witness the remarkable fruits of their joint intellectual, moral and spiritual labors. Had that been their consuming zeal—had they paused to lament that "there's not time enough"—there would have been no American miracle. Those early exemplars did not stop all else to reform the vast majority who do no politico economic thinking for themselves. Instead, they sought and discovered a social formula that encouraged and made it possible for the nonthinkers to cooperate to the best interests of themselves and all concerned.

There are numerous examples comparable to the above. And, assuredly, there have been ever so many instances of self-improvement resulting in monumental advances that have never been fully recognized and recorded. Indeed, it is certain that countless valuable social and political gains have been fathered by individuals who were unaware of their contributions. How come? The fruition of their exemplary behavior

and thinking blessed mankind long after their mortal moment—often decades or even centuries later! My admonition (to myself first of all) is that we set not our eyes upon saving or bettering humanity in our time. If such a result crowns our efforts, well and good; but our aim should be to strive for truth and righteousness all the time. To the extent that we succeed in self-improvement, to that extent will the general human situation be improved—though no one now knows the precise timing of the results.

No one knows what will happen in the next minute any more than he knows what will happen a century from now. It may very well be that an enlightenment of the past-no one knows how long ago—is to have its fulfillment right now, that is, in our time. And, by the same token, anyone's self-improvement of today may achieve fruition in the far-off future.

Let's have faith that such fulfillment—namely, a restoration of freedom—is in the immediate offing. This faith, however, can be absolutely justified only to the extent that there are individuals who pursue the path of self improvement. Adherence to what is right—exemplarity—will result in a significant abandonment of the wrong ways, particularly the deadening notion that "There isn't time enough for the right way."

Saint Matthew shares a faith and a promise that should sustain all devotees of freedom: "*There is nothing covered that shall not be revealed; and hid that shall not be known.*"

Again, the truth of freedom is about to be revealed and known. For there is not enough darkness in the whole world to put out the light of one small candle. Freedom is light—enlightenment—and cannot be extinguished!

## Nelson's Favorite Quotes

"There is a principle which is a bar against all information, which is proof against all arguments and which cannot fail to keep a man in everlasting ignorance - that principle is contempt prior to investigation." Herbert Spencer (1820 – 1903)

## Nelson's Newly Added Book Recommendations https://infinitebanking.org/books/

*The Brothers - John Foster Dulles, Allen Dulles. and Their Secret World War* — by Stephen Kinder

*Restoring America One County At A Time* — by Joel McDurmon

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

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

- Bill Skinner - Williamsburg, VA
- Scott Chapman - Sandersville, GA
- Howard Silvermintz - Atlanta, GA
- Kaye Lynn Peterson - Rancho Cordova, CA
- Dwayne Burnell - Bothell, WA
- Brian Fleming - Elm Grove, WI
- Jerold Wood - Robertsdale, AL
- Justin Hales - Grand Rapids, MI

*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.