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BUILDING THE 10%

DECEMBER • 2017

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LARA-MURPHY REPORT

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ABOUT LARA & MURPHY

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In 2010 he co-authored the highly acclaimed book, *How Privatized Banking Really Works* with economist Robert P. Murphy.

He is a co-creator of the IBC Practitioner Program for financial professionals and sits on the board of the Nelson Nash Institute.

ROBERT P. MURPHY is Research Assistant Professor with the Free Market Institute at Texas Tech University. He is co-author of *How Privatized Banking Really Works*. He is the author of *Choice: Cooperation, Enterprise, and Human Action* (Independent Institute 2015) and co-host with Tom Woods of the popular podcast Contra Krugman.

Murphy has a Ph.D. in economics from New York University. After spending three years teaching at Hillsdale College, he went into the financial sector working for Laffer Associates. With Nelson Nash, Carlos Lara, and David Stearns, Murphy is co-developer of the IBC Practitioner Program.

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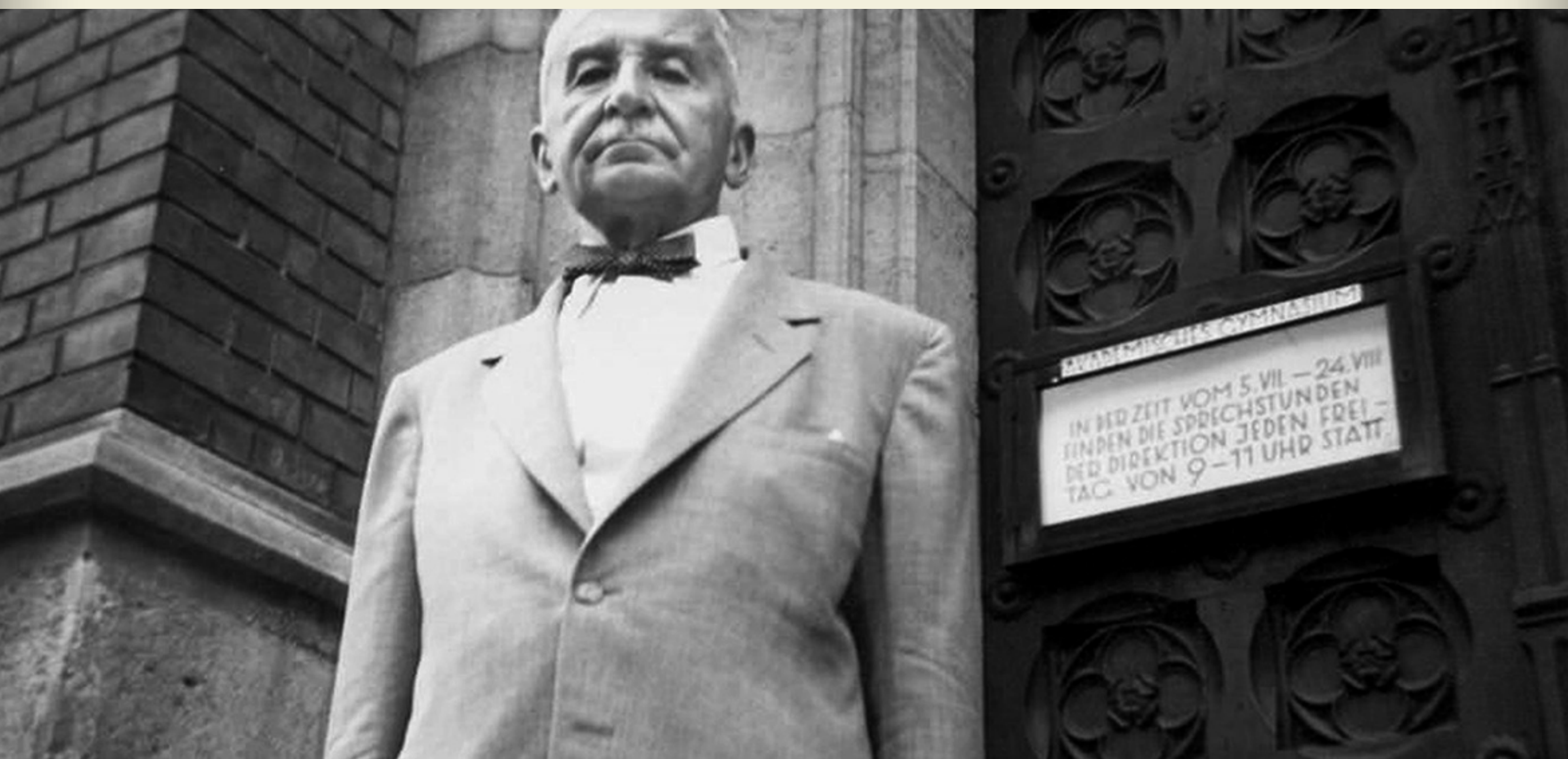
"It is impossible to grasp the meaning of the idea of sound money if one does not realize that it was devised as an instrument for the protection of civil liberties against despotic inroads on the part of governments. Ideologically it belongs in the same class with political constitutions and bills of rights. The demand for constitutional guarantees and for bills of rights was a reaction against arbitrary rule and the nonobservance of old customs by kings. The postulate of sound money was first brought up as a response to the princely practice of debasing the coinage. It was later carefully elaborated and perfected in the age which — through the experience of the American continental currency, the paper money of the French Revolution and the British restriction period — had learned what a government can do to a nation's currency system."

— Ludwig von Mises



One of the planks we offered in our book *How Privatized Banking Really Works* was a return to sound money. It is the theme running through our entire issue this month, even though we didn't plan it that way. The only *reason* computer brainiacs spent so much time developing the foundations that led up to Bitcoin, is that they didn't trust the governments and big banks of the world. And the Treasury's ability to issue massive loads of debt is propped up by the willingness of the Federal Reserve to monetize it. Thus, both of our articles in this issue ultimately flow from the fact that money has been taken out of the voluntary, private sector.

The Austrian economists have been the best at isolating the theoretical and practical importance of sound money. But though they could diagnose the problem, their solution—namely, educate enough people so that eventually government policy would change—seemed too distant and hopeless. In this context, Nelson Nash's *Infinite Banking Concept (IBC)* provides a breath of fresh air. As we explained in our book, IBC allows households and business owners to engage in "privatized banking" immediately, effectively seceding peacefully from the Wall Street / Federal Reserve / commercial banking nexus.

As a reader of the *Lara-Murphy Report,* you too must recognize the importance of these fundamental truths. Money and banking have been hijacked and perverted. Sometimes it can take generations for sin to reap its full consequences, but the day of reckoning is closer than many Americans realize. We hope our humble publication serves to keep you better informed than the masses.

Sincerely,
Carlos and Bob

Stocks Love Trump

THE US EQUITIES MARKET DEFINITELY PREFERRED THE DONALD TO HILLARY

Long-time readers know that we adhere to the Austrian theory of the business cycle. We have warned since the financial crisis of 2008 that the Fed's extraordinary measures have merely postponed the true reckoning. In particular, the booming stock market during the middle of the Obama years was—we believe—based on monetary inflation and was not sustainable.

Having said all of that, it is remarkable to see how much differently the stock market has behaved under the final years of Obama versus the year after Trump's shocking election upset:

SOURCE: St. Louis Federal Reserve

From early November 2014 through early November 2016 (just before the election), the S&P 500 rose a bit less than 5 percent total over the two years. Yet from election day 2016 through the end of 2017 (i.e. a bit more than a year), the S&P 500 has appreciated more than 25 percent.

What's even more interesting is that this stock boom under Trump occurred *while the Fed has been explicitly tightening*. In contrast, once the "taper" had been fully implemented in the fall of 2014 and the Fed was no longer buying new assets on net, the stock market was basically treading water under Obama.

There have been plenty of casual analyses claiming that the deregulation under the Trump Administration has contributed to more business investment. Furthermore, the big tax package (more on that in the next blurb) also is a reason for higher stock prices.

Although there are "fundamental" reasons to explain the surge in stocks under Trump, we still think that the US economy has been set up for a crash because of what the Fed did. Ironically, if a crash does occur, the media elites will no doubt blame it on the "reckless"

Tax Cut Closure

GOP GETS ITS TAX BILL THROUGH

On December 22, President Trump signed the tax bill into law. Among its major provisions, it reduces the corporate income tax rate from 35 to 21 percent, and placed a $10,000 cap on the deductibility of state and local taxes.

In our last issue (November 2017), we both devoted our articles to analyzing the pending GOP bills. (The details slightly differed in the House and Senate versions.) Although we stand by everything we wrote last month, we should mention three additional points regarding the final package, in order to provide a comprehensive treatment.

First, we didn't emphasize the (roughly) doubling of the standard deduction, which is now $24,000 for married couples. Recall that Murphy's article (from last month) focused on why the current "tax reform" was nothing like the famous Reagan-era version, because the *rate* reductions this time around were relatively small potatoes. However, the large boost in the standard deduction in the current package, means that more Americans will choose this option rather than opting for itemized deductions. In practice, then, this is a backdoor method of effectively "closing loopholes" without the political pain of literally removing them from the tax code. (In his interview this month, David R. Henderson praises the increase in the standard deduction, and implicitly he has these types of considerations in mind.)

Even though it would have been best of all from a "supply-side" perspective to lower marginal tax rates rather than to increase the standard deduction—which is the *opposite* of flattening the tax code—nonetheless, it reduces the politicians' ability to "pick winners and losers" if a large standard deduction means many taxpayers won't benefit from the itemized deductions.

Second, recall that both of us (Lara and Murphy) last month acknowledged that the Democratic critics had a plausible point when they complained about how many of the proposed tax changes catered to the wealthy. Again, everything we said on this topic was true, but our articles may have given a false impression of the overall impact of the changes.

According to the Joint Committee on Taxation (JCT), the distributional consequences of the new tax package are almost nonexistent, at least early on. (And as far as the "middle class tax cuts" that are scheduled to phase out down the road, the argument Republicans make—plausibly—is that no future Congress will vote to let those rates go up, when the time comes.) It's actually pretty amazing, in light of the heated rhetoric:

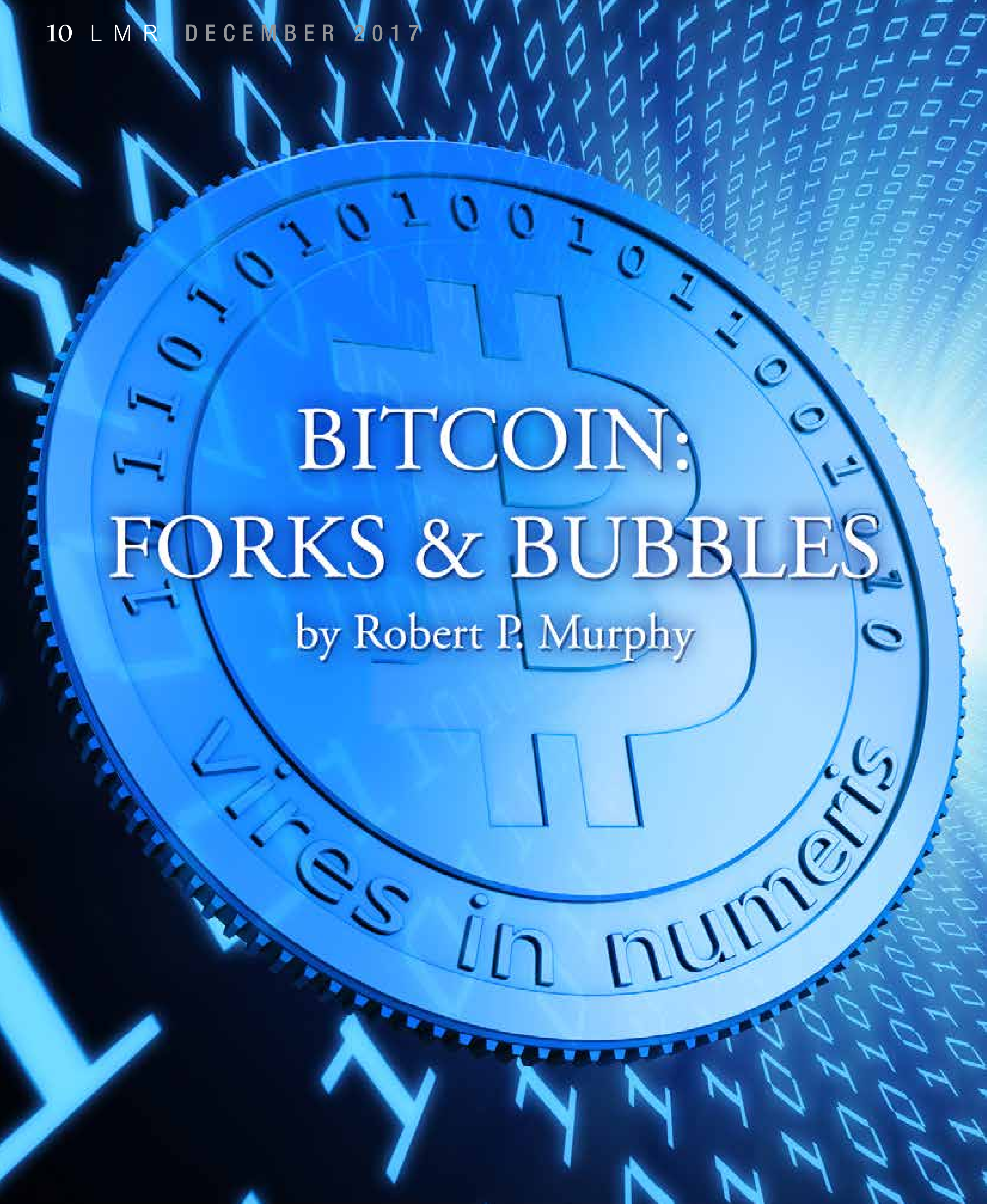
Income Category	% of Federal Taxes (Old)	% of Fed. Taxes under New Law in 2019
Less than $10,000	0.2%	0.2%
$10,000 to $20,000	-0.1%	-0.1%
$20,000 to $30,000	0.7%	0.6%
$30,000 to $40,000	1.5%	1.4%
$40,000 to $50,000	2.1%	2.0%
$50,000 to $75,000	8.2%	8.2%
$75,000 to $100,000	8.7%	8.7%
$100,000 to $200,000	29.1%	29.3%
$200,000 to $500,000	22.4%	22.2%
$500,000 to $1 million	7.9%	7.8%
$1 million and over	19.3%	19.8%

SOURCE: Joint Committee on Taxation

Third and perhaps most significant for the long term, the new tax law eliminates the penalty (the "individual mandate") for Americans without health insurance. President Trump incorrectly claimed that this aspect provided a major source of funding for Obama's signature Affordable Care Act. However, Trump is right that without the individual mandate, the rest of the ACA might crumble. We will return to this issue in the future as we learn more, but the immediate issue is this: The federal government still forces health insurers to offer plans to all applicants, regardless of medical condition. And yet, now there is no mechanism by which everyone is forced into the risk pool. Time will tell if this "tweak" paves the way for more freedom in the health care / insurance sector, or is used to justify a more complete federal takeover.

BITCOIN: FORKS & BUBBLES

by Robert P. Murphy



Several readers have asked me to comment on Bitcoin, as it's gone from being a curiosity to a financial phenomenon in the latter half of 2017. In this article, I'll summarize the "fork" that occurred in August—which created "Bitcoin Cash"—and the debate that still rages in the Bitcoin community. After that, we'll be in a better position to assess whether Bitcoin is currently in a bubble.

BITCOIN: THE BASICS

I've written previously ("The Economics of Bitcoin," April 2013) here in the *LMR* on the basics of Bitcoin. If you know nothing about Bitcoin, I refer you to that earlier piece to get a foundation. And for a very comprehensive treatment—which assumes you have no prior knowledge, yet walks you through ever more complex analogies to teach the underlying mechanics—you can download the free book I co-authored with Silas Barta, available at www.UnderstandingBitcoin.us.

For our purposes here, let me offer the following summary: Bitcoin is both a digital currency and a payment system wrapped up into one. It's somewhat like PayPal, in that you can send money to anyone with an internet connection.

However, what sets Bitcoin apart from all previous monetary and payment systems is that it is "peer to peer." Specifically, *there is no organization that is "in charge" of Bitcoin.* Rather, the entire history of all Bitcoin transactions are recorded in a public ledger, copies of which are stored on thousands of computers around the world. This history of transactions is the Bitcoin "blockchain," which was launched in 2009 shortly after the pseudonymous "Satoshi Nakamoto" in 2008 published his (?) famous 9-page white paper explaining the protocol of Bitcoin.[1]

It's beyond the scope of our discussion here, but Bitcoin ensures the authenticity of transactions through an ingenious use of cryptography, where people can "spend" their bitcoins by using a private key to digitally "sign" transactions and thus prove to the world that they are the legitimate owners of those bitcoins. (Silas Barta and I explain this thoroughly in our "Understanding Bitcoin" booklet.) The broad term for Bitcoin is *cryp-*

What sets Bitcoin apart from all previous monetary and payment systems is that it is "peer to peer." Specifically, *there is no organization that is "in charge" of Bitcoin.*

tocurrency, which is a reference to the cryptography involved in the protocol governing transactions.

THE CRYPTO MARKET

Although Bitcoin was the first cryptocurrency, there are now thousands of cryptocurrencies. As of this writing, the leading cryptocurrencies by market capitalization (i.e. the number of outstanding units of the currency times its market price in dollars) are:

Although Bitcoin was the first cryptocurrency, there are now thousands of cryptocurrencies.

Table 1. Ranking of Cryptocurrencies by Market Cap

Cryptocurrency	Market Cap
Bitcoin	$221 billion
Ethereum	$111 billion
Ripple	$63 billion
Bitcoin Cash	$41 billion
Cardano	$16 billion

SOURCE: https://coinmarketcap.com/

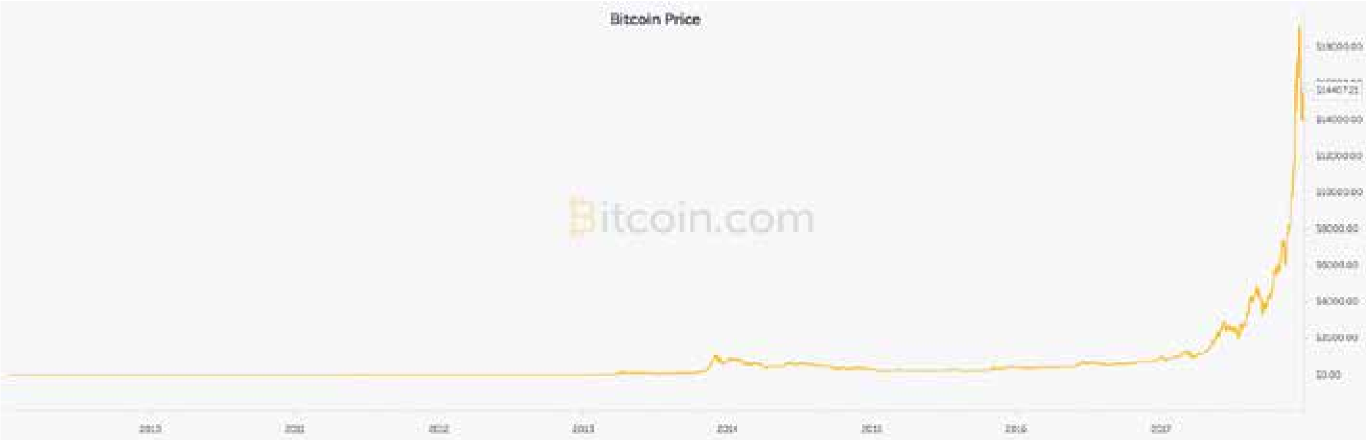
As the table indicates, the market cap of the leading cryptocurrencies is simply astonishing. (For a frame of reference, consider that the market cap of the Coca-Cola Company is "only" $196 billion.)

Besides their current market value, however, what's *really* amazing about cryptocurrencies is how *quickly* they attained their stature. Figure 1 shows the price history of Bitcoin.

Bitcoin traded below $1 from its birth in 2009 through early 2011.[2] Then it zoomed up to an incredible $29 in June 2011—in other words, a 28-fold increase in half a year—before crashing soon after, down to the $2 - $3 range. At this point, many onlookers declared, "Bitcoin is dead." It had been a goofy science experiment that a bunch of computer geeks had dabbled with, but *surely* it had run its course now that it went waaaaaay up and then crashed.

The next major peak occurred in April 2013, when Bitcoin broke $213. (It had started that year at only $13 and change.) At the time, many linked Bitcoin's explosion in price to the bank crisis in Cyprus.[3] But then Bitcoin crashed hard and was back to $70 by July. Again, the critics thought that had

Figure 1. USD Price of Bitcoin, 2009 - 2017



SOURCE: www.Bitcoin.com

to be the end of it. After all, you can't eat bitcoins or use them in production, so surely the price would fall to $0 where it belonged. Any day now.

Then things got "crazy," with Bitcoin soaring to $1132 by late November. (We are still in the year 2013 in our narrative.) Yet it crashed down to $510 by the end of the year (!!), once again confirming for the cynics that Bitcoin was an insane financial asset and was *surely* dead at this point.

Bitcoin would not break $1000 again until early 2017. But then things kept going up, causing more and more people to take notice of this odd new asset. It broke $2000 in May. It broke $4000 in August. It broke $8000 in November. It broke $16,000 in early December.

Finally—as of this writing—Bitcoin peaked at an incredible $19,499 on December 18, 2017. At that point, its year-to-date appreciation was some *1800 percent.*

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THE CONGESTION PROBLEM

Currently, the major controversy within the Bitcoin world concerns the problem of network traffic. Ironically, Bitcoin has become a victim of its own success. So many people are attempting to use Bitcoin, that the fee for implementing a transaction (as of this writing) can be close to $30. Since Satoshi Nakamoto's original vision of Bitcoin was a private, convenient way for "unbanked" people to send payments around the world, it is ironic that it's currently cheaper (at least for small sums) to route money using Western Union!

The fundamental limitation is that each new "block" of transactions is only 1 megabyte in size.[4] The way the Bitcoin protocol works, the network automatically adjusts the difficulty of confirming transactions so that one new block gets added to the chain (i.e. the public ledger) every 10 minutes. (In other words, if more computers enter the industry to try to "mine" new bitcoins, then the difficulty of the computational problems is automatically bumped up, so that on average it still takes 10 minutes before a computer in the network "solves" the problem, adds the block of new transactions to the existing chain, and gets awarded new bitcoins.)

Ironically, Bitcoin has become a victim of its own success.

The original protocol design was chosen as a compromise among different goals, such as (1) allowing the "mining" process to be implemented by more (and less powerful) computers and thus to reduce the ability of any group to engage in fraud, (2) minimizing the amount of wasted computation by the network on "obsolete" versions of the blockchain, and (3) protecting the entire system from "spam" transactions from malicious attackers. These types of considerations led to the original protocol, whereby a 1 MB block of transactions would be added to the existing public ledger roughly every 10 minutes.

The problem with this approach, however, is that it means the original Bitcoin protocol can only process about 7 transactions per second. In contrast, Visa and Mastercard have the ability to handle many *thousand* transactions per second. As Bitcoin grew in popularity, this choke point was eventually going to really chafe the average user.

Currently, the solution is that people have to append a fee to incentive the "miners" to include their transaction in the next block. (It used to be that people who were willing to wait could have their transactions eventually added to the ledger for free.) But this has led to a massive schism in the Bitcoin world.

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TWO VISIONS FOR DEALING WITH THE CONGESTION[5]

On the one hand, you have people committed to the vision of keeping Bitcoin's computational framework dispersed among as many "miners" as possible, to limit the ability of any group of powerful computers from "double spending" bitcoins fraudulently. This camp acknowledges that in the short term, this approach will require high fees for people who want their transactions to go onto the ledger. As a compromise, programmers in this area are working on "off-chain" technologies, so that people can still shuffle around *claims* to bitcoins with only periodic "settling up" vis-à-vis the actual Bitcoin blockchain.

The people who like the Bitcoin protocol the way it is, think that the actual transfer of bitcoins will be reserved to those who are willing to pay for it. Other users who want to "spend" bitcoins to buy a cup of coffee, etc., don't actually need such mundane transactions clogging up the public ledger that will exist for eternity.

I realize this may be getting too technical for many readers—and I myself only understand the vague principles of the dispute!—but try this for an analogy: Imagine the actual *money* in the economy is big hunks of gold bullion. For various reasons, gold is an excellent money. Yet it is difficult to lug around for day-to-day transactions. For this reason, banks might offer convenient services where they issue checkbook accounts and/or paper notes, which are merely legal *claims* on the hunks of metal stored in the bank vaults. So occasionally individuals and businesses would settle up the net differences in their transactions, but most of the commerce would involve the "superstructure" built on top of the underlying transfers of physical gold.

So by analogy, the people who like the Bitcoin protocol the way it is, think that the actual transfer of bitcoins will be reserved to those who are willing to pay for it. Other users who want to "spend" bitcoins to buy a cup of coffee, etc., don't actually need such mundane transactions clogging up the public ledger that will exist for eternity. Instead, they can buy their coffee using other services that keep track of people's accounts, denominated not in gold or even US dollars, but in bitcoins. For this first camp, the truly essential feature of Bitcoin is that the process by which its transactions are verified remains *decentralized*, so that no one group is "in charge" of the network.

The second vision, in complete contrast, rejects the notion of Bitcoin as a form of "digital gold" that is stored in vaults and only moved around at the behest of wheeler dealers. No, this second camp wants Bitcoin to be the "people's money" of the future. For this group, high transaction fees are fatal. They point out that merchants aren't going to accept bitcoins if they have to pay higher fees than they do for credit cards.

Technically, this group opts for the capacity of a greater number of transactions to be processed per unit time, at the "cost" of the blockchain validation being concentrated in fewer computers. Thus, this group emphasizes the digital cash payment aspect of Bitcoin as its truly essential feature.

WHAT THE FORK?! BITCOIN CORE VS. BITCOIN CASH

On August 1, 2017, there was a *literal* split in the community, in what is known as a "hard fork." From that point forward, some computers continued to process new transactions (and add them to the ledger that existed at the time of the fork) according to the original rules. But other computers decided to process new transactions and add them to a *branch* off of the original blockchain, according to new rules.

The new protocol is called "Bitcoin Cash." To avoid confusion, the original protocol is now called "Bitcoin Core." And one of the big fights in the community is whether the generic term "Bitcoin" should refer to one or the other, since both camps feel that their vision is closer to that described in Nakamoto's original white paper.

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IS BITCOIN A BUBBLE?

Long-time readers know that Carlos and I have been warning that US Treasuries, stocks, and (more recently) real estate are surely overvalued and headed for a sharp correction. We believe that seven years of zero-percent interest rates and the incredible intervention of the Fed in the bond markets has set the economy up for a giant crash.

In that context, it would be silly for me to look at the chart of Bitcoin's price history and *not* conclude that it too was at least partly fueled by irresponsible monetary policy. And yes, it is true that if Bitcoin were to crash by 50% or more in 2018, nobody would have any right to be surprised. After all, Bitcoin has crashed hard several times already in its brief life. (Indeed, as of this writing it has fallen significantly from its all-time peak.)

However, I also believe that this very history gives us reason to think that Bitcoin and other cryptocurrencies are here to stay. After all, if the previous crashes didn't scare off investors, why would the next one?

I am *not* recommending any particular cryptocurrency as an investment, but I *do* believe that by the year (say) 2050, it will be commonplace for people to own units of one or more cryptocurrencies. This trend for adoption of cryptocurrencies will be accelerated if there are any crises in the traditional fiat currencies issued by the political authorities.

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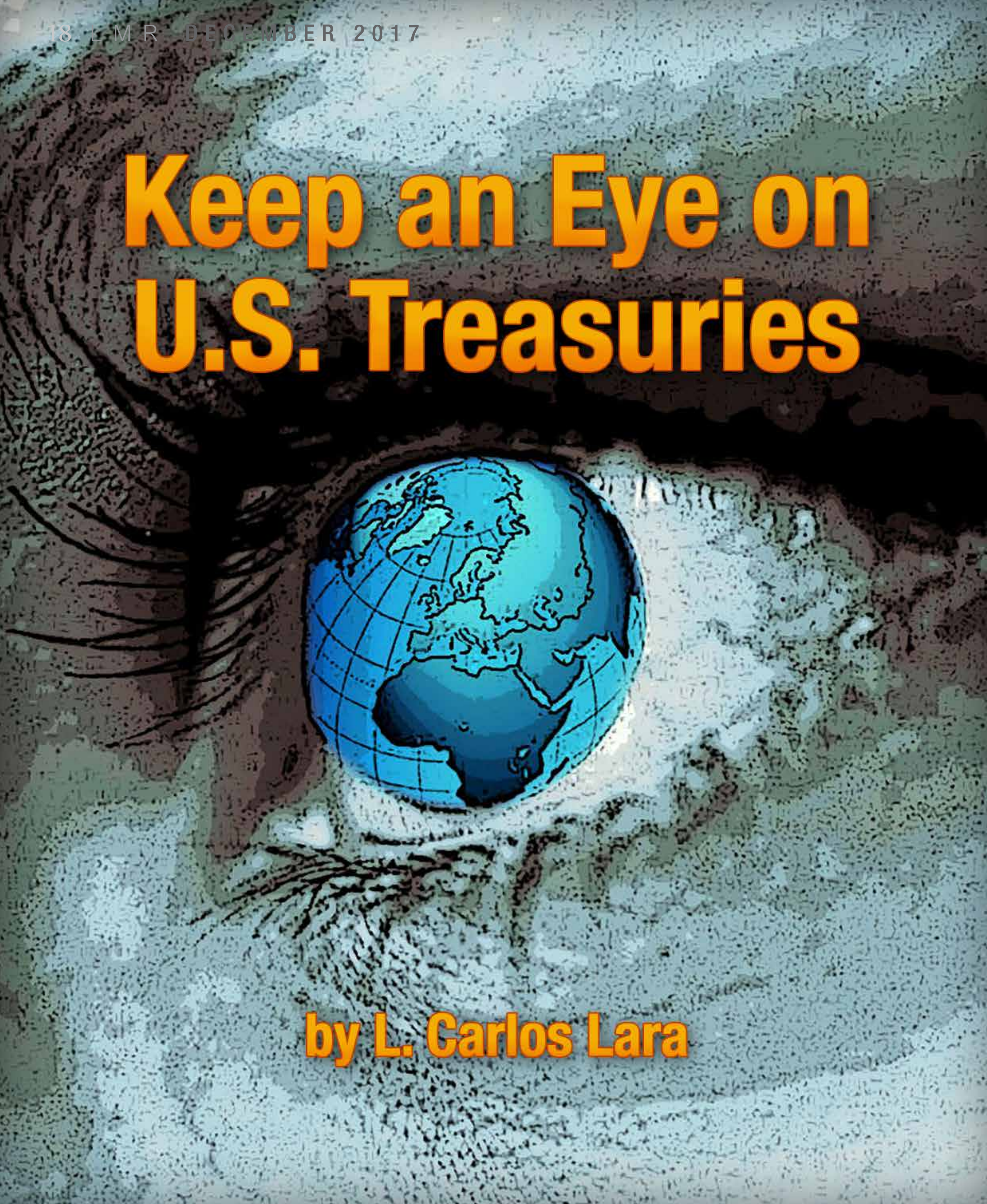
CONCLUSION

Contrary to the glib comparisons to tulip bulbs and baseball cards, there really *is* a brand new technology—namely, the blockchain—that was introduced to the world in the form of Bitcoin. The idea that a public document—whether a list of financial transactions, or a register of land titles, or a compilation of wagers[6] on the Super Bowl—can arise in which no one person or company has the power to dictate its content, is something truly revolutionary. Humans are still coming to grips with the implications of this new capability that "Satoshi Nakamoto" unleashed in 2008. ◆◆◆

References

1. A copy of the famous Bitcoin white paper is available at: https://bitcoin.org/bitcoin.pdf.
2. Bitcoin price history available at: https://99bitcoins.com/price-chart-history/.
3. See for example: https://www.cnbc.com/id/100597242.
4. A note for purists: Some argue that the original 1MB limit on block size in the original Bitcoin protocol is no longer completely accurate, once we take into account the "SegWit" updgrades. I will not include such considerations in this article.
5. A recent episode of the Tom Woods podcast featured a debate between proponents of these two camps. See: https://tomwoods.com/ep-1064-the-debate-within-bitcoin-jameson-lopp-vs-roger-ver-on-bitcoin-and-bitcoin-cash/.
6. To see how gambling can be implemented using blockchain technology see: https://cointelegraph.com/news/how-blockchain-technology-is-taking-gambling-industry-to-new-level.



Keep an Eye on U.S. Treasuries

by L. Carlos Lara

THE DOMINANT INVESTMENT STRATEGY this past year has been the stock market. If you have invested your money in equities your portfolio has most likely done exceptionally well. But why is it that when you talk to stock market investors they don't seem to be all that happy about it? My guess is that all that extraordinary performance is all on paper and they know it. To make sure they are not left holding the bag when it all crashes you have to get out *now* in order to realize the gains. The problem is that you may be getting out too early while the market

When you talk to stock market investors they don't seem to be all that happy about it? My guess is that all that extraordinary performance is all on paper and they know it.

is still rising and wind up underperforming against previous years' losses. If you are investing in the stock market from within a qualified plan, the problem gets even more complicated. So it really does create an uncomfortable conundrum of sorts for the equity investor. What's the point of making all that money if in the end you can't hold on to it?

Real estate, an alternate investment strategy that is also surging with high market prices, faces a similar risk dilemma. Consequently, beneath the surface of all the current real estate euphoria there is plenty of anxiety among its crowd of investors. What is unfortunate is that far too many of these stock and real estate investors are mainly in these markets in order to save for their retirement, which is a gross misunderstanding of these distinctly different activities.

There is savings and then there is investing. Bob and I wholeheartedly believe in both types of pursuits. But we are also very clear in distinguishing the risk differences between the two. This is why we believe that the securest cash flow management process for accomplishing both is by using the *Infinite Banking Concept (IBC)*. Naturally, if folks don't know about IBC and its companion platform—participating Whole Life insurance, then for them no other viable safe strategies to grow and protect one's money exist. Nor will they know that you can deploy these accumulated savings from within this same system to take advantage of investing opportunities as they arise.

Since *investing* by its very nature is tied to risk, understanding *Austrian Business Cycle Theory (ABCT)* is what we use to gauge and manage our investment decisions. ABCT provides insights into the actions of the Federal Reserve, which always roils financial markets. This is why we recommend integrating the two concepts, *IBC* and *ABCT,* for the ideal money management strategy.

What you should know about Bonds

Readers of the ***LMR*** are well acquainted with our position on why these two markets in particular (stocks and real estate) have skyrocketed into an unsustainable boom that is due to collapse. Briefly stated, it's been a combination of an incredibly (Fed induced) low interest rate environment coupled with massive purchases of government bonds by the Fed commonly known as *Quantitative Easing (QE).* For an excellent review of how this decade-long buying spree transpired see Bob's article in the July 2017 issue of the ***LMR*** entitled "Rising Interest Rates and Bank Balances."

In the very same issue my article titled, "Warning: Market Volatility Ahead—And Soon!" analyzed the Fed's *new* plan to reverse its course and unwind its balance sheet now containing $4.5 trillion in purchased assets. Over the course of the next three to five years it plans on selling off a growing amount of Treasuries and mortgage-backed securities. In the beginning, the Fed will sell $6 billion in U.S. Treasuries and $4 billion in MBS per month—a dicey move at this particular time—and the amount is scheduled to grow slowly, until eventually the Fed will be

the unwinding process has officially begun as interest rates continue to inch upward and financial markets hang in the balance.

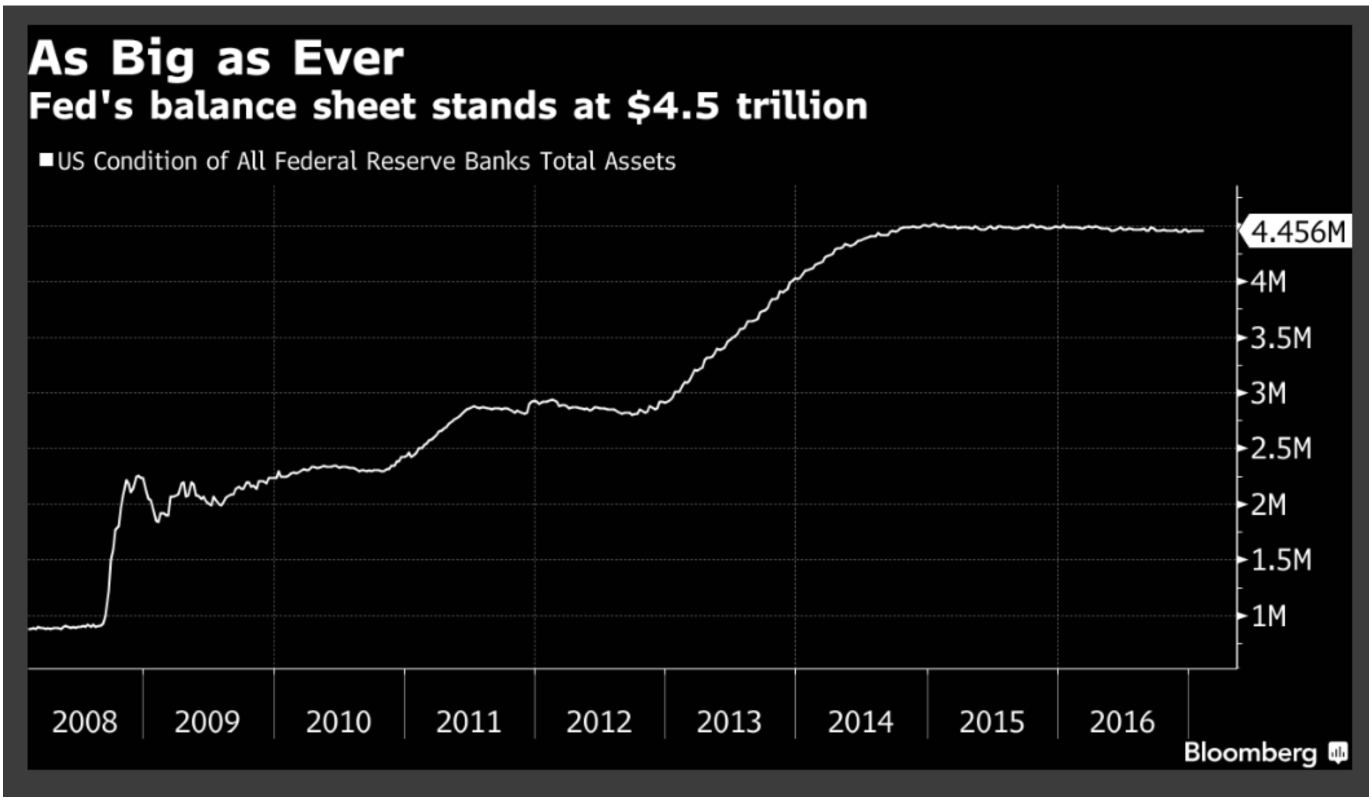
unloading $30 billion in Treasuries and $20 billion in MBS per month. Will they actually pull the trigger? On November 3, 2017 the Federal Reserve's report on its portfolio holdings actually showed its first near $6 billion decline since 2012.[1] In other words, the unwinding process has officially begun as interest rates continue to inch upward and financial markets hang in the balance.

As my article went on to point out, it appears as though the flood of bonds that will be coming into the marketplace on account of this massive unloading will be absorbed by the banking system. The loosening of certain commercial banking regulations within the Dodd-Frank Act will make it possible for banks to purchase these bonds without having to undergo the expense of increasing their reserves—an actual boon for big banks especially. Not so good for bank depositors if and when the next widespread financial banking crisis erupts.

But let's keep all this in perspective. The Fed's balance sheet, as epic in size as it is at $4.5 trillion, is only a portion of the entire $14.5 trillion U.S. Treasuries market. There is more tension and worry that lies elsewhere. Note that $6.5 trillion of this total is owed to foreign investors. This is twice the amount owed to foreigners since 2008. China and Japan are the two largest U.S. foreign creditors and account for $2 trillion between them. In other words, we (the U.S.) have never owed others, especially foreigners, this much money. Point being, we are the world's largest debtor nation.

What if there is a drop in demand for Treasuries?

The most important fact to keep in mind is that government relies on U.S. Treasuries to finance its *deficits.* In other words, gov-



MAJOR FOREIGN HOLDERS OF TREASURY SECURITIES
(in billions of dollars)
HOLDINGS 1/ AT END OF PERIOD

Country	Oct 2017	Sep 2017	Aug 2017	Jul 2017	Jun 2017	May 2017	Apr 2017	Mar 2017
China, Mainland	1189.2	1180.8	1200.5	1166.0	1146.5	1102.2	1092.2	1088.1
Japan	1093.9	1096.0	1101.7	1113.1	1090.8	1111.3	1106.9	1120.5
Ireland	312.4	310.6	307.0	310.8	302.5	295.8	299.9	313.9
Brazil	270.0	272.8	273.6	271.9	269.7	269.7	267.7	259.5
Cayman Islands	269.9	267.6	260.0	259.2	265.2	266.1	256.8	250.4
Switzerland	254.0	254.9	248.3	244.8	244.5	239.5	234.1	227.8
United Kingdom	225.9	237.4	225.4	229.7	237.1	234.4	231.5	228.3
Luxembourg	217.9	213.9	213.3	213.0	211.7	207.7	212.1	218.3
Hong Kong	192.3	194.7	197.3	199.1	202.6	196.3	196.6	195.1
Taiwan	181.7	183.9	180.4	182.5	184.4	181.2	185.6	183.8
Saudi Arabia	145.2	136.7	137.9	142.5	142.8	134.0	126.8	124.5
India	141.4	145.1	138.9	135.7	130.3	127.3	124.1	117.1
Singapore	130.4	125.2	119.3	112.3	106.4	107.9	107.0	103.1
Belgium	116.0	104.8	96.9	99.4	98.3	98.7	96.4	109.9
Russia	105.0	103.9	105.4	103.1	102.9	108.7	104.9	99.8
Korea	100.1	94.3	95.0	97.9	96.8	100.1	93.8	97.1
Canada	78.2	75.1	73.6	75.7	76.6	80.2	80.6	77.6
France	75.9	75.4	76.1	80.0	72.3	74.4	66.9	69.9
Germany	72.9	74.9	73.0	73.3	68.4	68.3	74.7	77.0
Thailand	68.4	70.8	71.6	67.2	66.1	66.5	69.7	69.3
Bermuda	63.5	62.6	62.7	61.7	60.9	60.9	59.4	59.7
Turkey	61.4	60.8	57.7	54.5	58.9	49.5	56.4	59.0
Norway	60.6	64.1	58.0	54.8	53.8	48.3	51.4	48.9
United Arab Emirates	57.7	54.3	55.9	59.9	58.9	60.5	60.6	63.0
Sweden	45.3	45.9	44.3	42.7	40.5	40.8	41.1	40.6
Netherlands	45.1	47.5	50.3	50.5	53.1	52.2	49.1	51.2
Mexico	41.6	40.5	34.7	35.8	32.3	38.9	40.2	38.8
Kuwait	39.4	38.0	35.6	33.0	31.8	31.6	31.3	32.4
Poland	38.8	37.3	36.3	35.6	34.1	35.0	33.9	34.9
Australia	38.7	36.9	37.8	37.9	38.1	37.0	35.2	37.6
Spain	36.9	38.1	38.2	38.2	36.6	38.2	38.6	38.0
Philippines	36.4	35.5	36.3	38.1	37.9	38.2	38.1	36.6
Italy	34.5	35.3	35.4	36.2	36.1	35.6	35.0	35.2
Israel	32.7	32.5	31.8	30.4	30.9	30.9	29.5	29.6
All Other	476.2	475.2	458.6	463.9	451.6	455.7	445.5	442.3
Grand Total	6349.4	6323.0	6268.4	6250.3	6171.6	6123.6	6073.7	6079.1
Of which:								
For. Official	4079.1	4070.4	4051.7	4034.5	3995.3	3935.2	3911.6	3879.9
Treasury Bills	332.2	325.2	324.1	330.6	330.5	329.3	326.5	317.8
T-Bonds & Notes	3746.9	3745.2	3727.6	3703.9	3664.9	3605.9	3585.1	3562.2

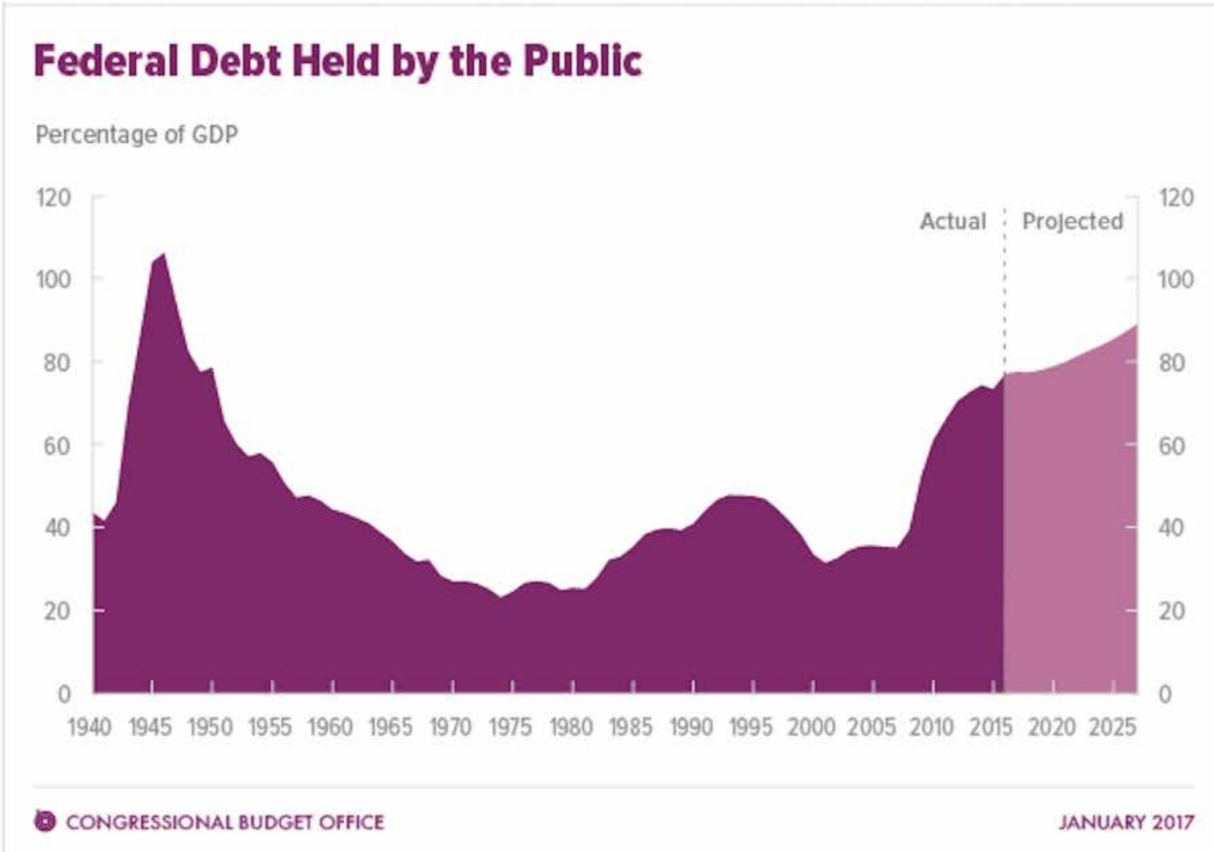
Department of the Treasury/Federal Reserve Board

ernment spending far exceeds its tax revenue. This was probably one of the most important truths Bob and I made clear in our book *How Privatized Banking Really Works* to help our readers understand that government does not have any money of its own and must borrow from others to pay its bills. Making this borrowing process possible is one of the primary roles of the Federal Reserve and the role of all central banks around the world.

Our growing deficits here in the U.S. projected through 2027 reveal the future increase of our federal debt. The projections take into consideration the growth in government spending particularly for Social Security, Medicare and the enormous *interest* being paid on existing debt. Today in the current period— post the *GOP Tax Reform*, spending will continue to outstrip tax revenue and increase the deficit by an additional $1.4 trillion over the next 10 years due to the new tax cuts. Will we as average taxpayers actually pocket this money? Many believe that it is highly unlikely.

As the Congressional Budget Office (CBO) puts it:

> *"As deficits accumulate in CBO's baseline, debt held by the public rises from 77 percent of GDP ($15 trillion) at the end of 2017 to 89 percent of GDP ($25 trillion) by 2027. At that level, debt held by the public would be the largest since 1947 and more than twice the average over the past five decades in relation to GDP (see figure below)."* [2]



Reduced demand for U.S. Treasuries when government's cash flow is running in the deficits would force government to pay a higher interest rate on the new bond issues in order to induce new investors to buy them. Yet this higher interest payment increases government's cost of finance and puts even more pressure on the already shattered U.S. budget.

The bad news is that both China and Japan have actually sold off and pulled back from buying U.S. Treasuries. China peaked in 2013 and Japan unloaded a considerable amount in 2014. Consequently, there is legitimacy to the fear that we as a nation may now be cornered. Should we be worried? This is why I am suggesting that we keep an eye on U.S. Treasuries.

There is legitimacy to the fear that we as a nation may now be cornered. Should we be worried? This is why I am suggesting that we keep an eye on U.S. Treasuries.

U.S. Treasuries outrank all other asset classes

Despite the vulnerability and volatility of U.S. Treasuries, compared to other asset classes like real estate, stocks, and other foreign debt instruments, they are by far less risky for a very important reason.

U.S. Treasuries are dollar-denominated assets and fortunately the U.S. Dollar continues to be the *reserve* currency of the world. Basically, all of the world's developed economies accumulate dollar reserves in order to enhance their own money supply and creditworthiness. These dollar stockpiles take the form of what foreign countries still believe to be the safest credit instrument on the planet—U.S. Treasuries.

Regardless of political rivalry the U.S. may have with foreign nations, such as in the case with China and even Japan, they are locked in an interdependent symbiosis with the U.S., which benefits both parties and cannot be denied.

In addition to this, available creditworthy investment options were reduced even further with the emergence of below-zero bond yields generated by the European Central Bank and the Bank of Japan. The U.S. Treasuries, even though having historically low yields, still lured in bond investors with yields that were positive. The point is that sovereign countries use their fixed income strategists to manage their portfolios of Treasuries according to market conditions and investment needs.

It's also important to realize that these credit instruments (government bonds) have played a major role in capital formation as well as income production for institutions and governments for centuries. They are the veritable backbone for any economy since this is how convertibility to cash is made most readily available to investors. In today's world U.S. Treasuries are viewed as being the pinnacle of credit worthiness.

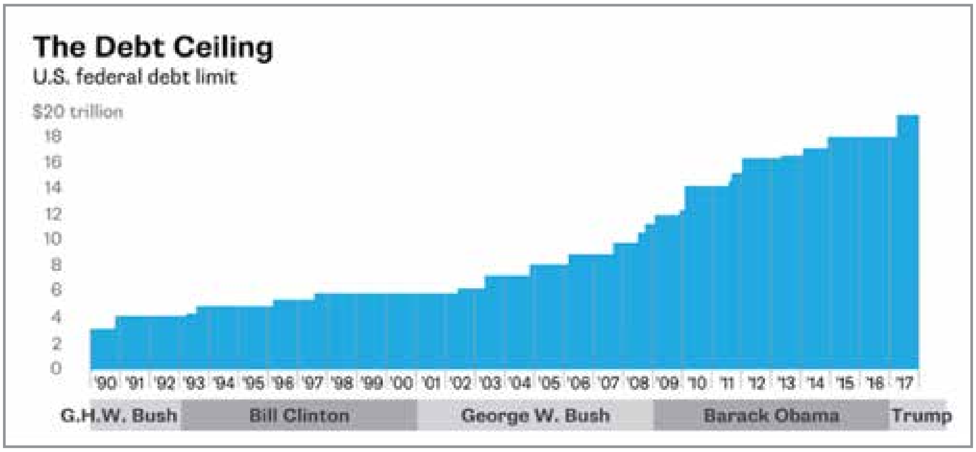
What about the Debt Ceiling?

Think of the debt ceiling as a line of credit the U.S. government established for itself to make it easy to borrow money from itself up to a set limit. Its original intent was to set a cap on excessive borrowing, and also was a means by which the Congress could prevent the Executive from engaging in unauthorized spending (which is supposed to run through Congress) by floating Treasury bonds. This will help frame what can often be a puzzling problem. The process to create the borrowed money, as we have already explained, is done by issuing U.S. Treasuries. The first Debt Limit was established one hundred years ago (1917) to provide the Executive the flexibility to issue bonds to fund its efforts in World War I without needing Congressional approval for each issue (as was the case previously). Even though the debt ceiling has been raised numerous times since then, these occasions often lead to fearful talk of having to close down the government and that its many expenditures will not be paid. Social Security and Medicare recipients especially are the most upset when the limit is near reaching its cap.

What's more, the language taken directly from the U.S. Department of the Treasury is itself ominous, making it almost impossible not to raise the debt ceiling. The average person wants no part of the scenario they describe:

> *"Failing to increase the debt limit would have catastrophic economic consequences. It would cause the government to default on its legal obligations – an unprecedented event in American history. That would precipitate another financial crisis and threaten the jobs and savings of everyday Americans – putting the United States right back in a deep economic hole, just as the country is recovering from the recent recession."*[3]

At the same time it's not surprising how over the years the debt limit has become a political tool among lawmakers to help negotiate contentious disagreements between Republicans and Democrats. It's one of the main reasons many seek to abolish it altogether. Whatever the outcome to that debate will be we can be sure that our government's spending problem seems incurable and government's dependency on issuing U.S. Treasuries to fund its expenditures seems equally unstoppable.



Conclusion

The past eighteen months have been extraordinary for stock investors to the point that it has been difficult to lose money and yet there is uncertainty lurking beneath the surface of all the euphoria. Real estate investors display similar traits, but the question is why. If only there were other hot investment opportunities you could move your money to it would help take away some of the weirdness of there being only these two dominate strategies that most serious analyst agree are due for a major correction. What is an investor to do?

In previous issues of the ***LMR***, during the same eighteen-month period, Bob and I have explained in detail the reason for the conundrum that currently exist. We can say it in one sentence—the euphoria in markets has been Federal Reserve induced. It's true that there have been regulatory and tax changes under the Trump Administration that, considered in isolation, could provide expectations of a better economy, but that doesn't change the years of malinvestments that occurred because of the Fed's easy-money policies.

By being able to see the big picture we can all make better investment decisions. But in additions to this, investors are well advised to keep a close watch on U.S. Treasuries, in fact, all bonds for that matter. As interest rates begin to rise you will soon learn the importance of that suggestion.

My final suggestion would be to open up a conversation with an *Authorized IBC Practitioner* about *IBC*. You can locate one of our graduates here: https://infinitebanking.org/finder/

If you have not yet made the move to ***IBC*** right now may be the best time to do it.

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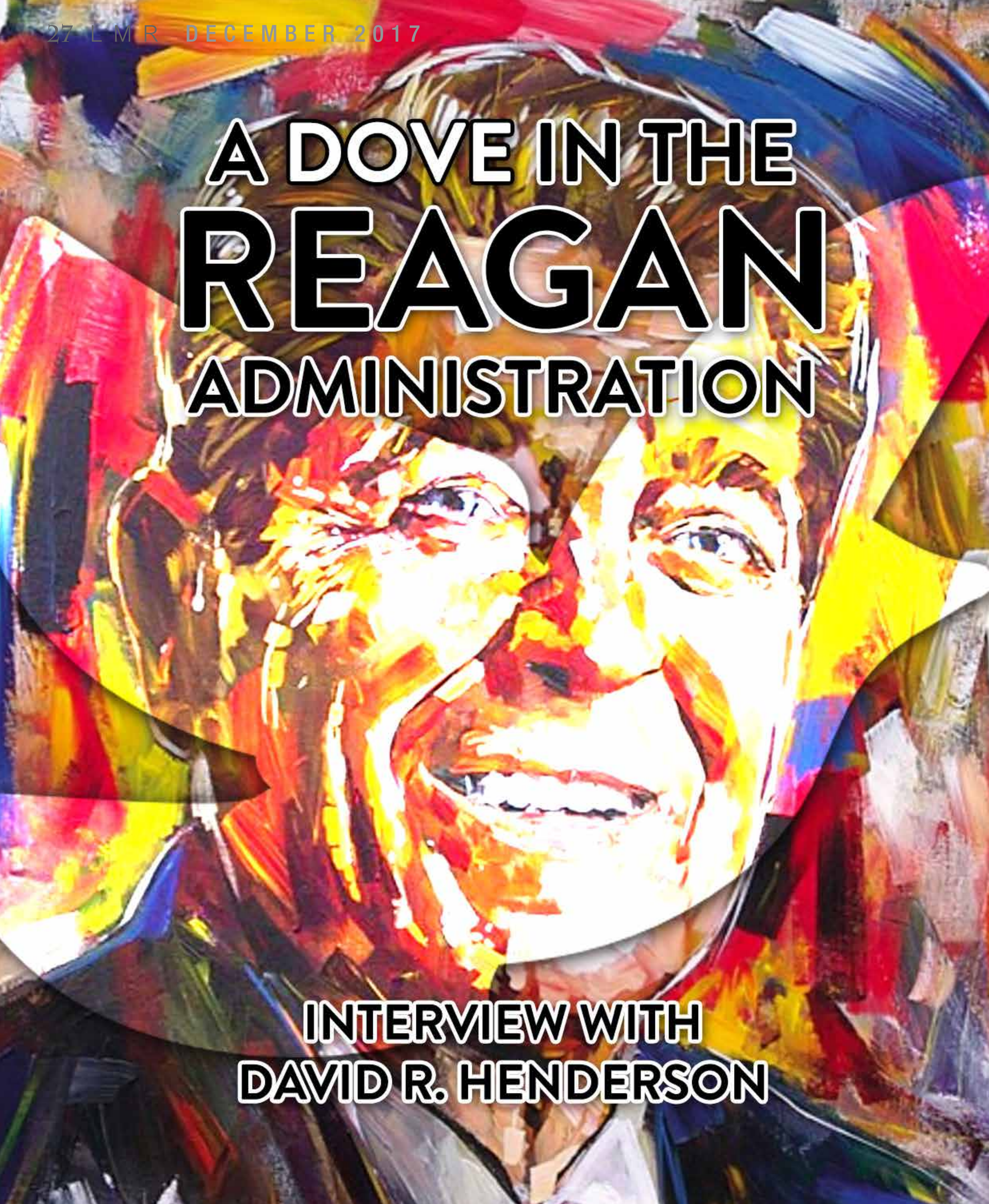


A DOVE IN THE REAGAN ADMINISTRATION

INTERVIEW WITH DAVID R. HENDERSON

DAVID R. HENDERSON

is an Emeritus Professor of Economics at the Naval Postgraduate School in Monterey, California, a Research Fellow with the Hoover Institution at Stanford University, and a Senior Fellow with the Fraser Institute in Vancouver, Canada. He was previously a senior economist for health policy and for energy policy with President Reagan's Council of Economic Advisers.

David is the editor of The Concise Encyclopedia of Economics, the only reader-friendly encyclopedia of economics. His book, The Joy of Freedom: An Economist's Odyssey has been translated into Chinese. His book Making Great Decisions in Business and Life, co-authored with Charles L. Hooper, has been translated into Korean.

He has written over 300 articles for such popular publications as the Wall Street Journal, New York Times, Barron's, Fortune, Los Angeles Times, Washington Post, The Hill, USA Today, Chicago Tribune, Public Interest, National Review, Red Herring, and Reason. He has also written scholarly articles for such journals as: Journal of Policy Analysis and Management, Independent Review, Cato Journal, Regulation, Contemporary Policy Issues, Defense & Security Analysis, Eastern European Economics, Econ Journal Watch, and Energy Journal.

He has testified before the House Ways and Means Committee, the Senate Armed Services Committee, and the Senate Committee on Labor and Human Resources. He has also appeared on C-SPAN, CNN, the Jim Lehrer Newshour, the John Stossel show, the O'Reilly Factor, and MSNBC, RT, NPR, CBC, and the BBC.

Born and raised in Canada, he moved to the United States in 1972 to earn his Ph.D. in economics at UCLA. He proudly became a U.S. citizen in April 1986.

LARA-MURPHY REPORT: We know you are eclectic and don't subscribe to any one label, but can you share with our readers your early experience with the Austrian School?

DAVID R. HENDERSON: I first heard about the Austrian School by reading Ayn Rand. In my first year of college at the University of Winnipeg in the fall of 1967, I read *The Fountainhead* and *Atlas Shrugged* and was hooked. The next summer, I discovered Ayn Rand's non-fiction books *Capitalism, the Unknown Ideal* and *The Virtue of Selfishness* and from there went to reading her *Objectivist Newsletter.* I borrowed a bound volume from my friend and mentor Clancy Smith and read almost every book she recommended. The ones that stood out in economics were Henry Hazlitt's *Economics in One Lesson* and Ludwig von Mises's *Planned Chaos.* I also discovered Milton Friedman's *Newsweek* columns that summer of 1968 and, from there, went on to read *Capitalism and Freedom.* I mention that because early on, I decided that it didn't make sense to be of one school of thought. If someone said something that I thought was both important and true, then it made sense to me to accept it, not to ask what school of thought it represented. So, for example, in my last year of college, I took my first economics course—I was a math major—and the textbook we used was *Economics* by Paul Samuelson and Anthony Scott. (Scott was a Canadian economist who added the material on Canadian institutions.) I didn't like the book at all, but they had a section on how futures markets warn people about, say, a coming crop failure, and I thought it was awesome. The main Austrian I read during college was Friedrich Hayek. I started with *The Road to Serfdom* after one of my mentors gave it to me for Christmas. I got about 20 pages in and put it down because I didn't like it. I thought he was way too graceful to those totalitarians whose ideas

"The main Austrian I read during college was Friedrich Hayek."

he and I despised. I tried again about 6 months later and loved it. I think my own views about treating those with whom one disagrees with good will had evolved in that time. I went from there to Hayek's Studies in *Philosophy, Politics, and Economics,* and loved that too, and then to his essays in *Individualism and Economic Order.* I especially liked the essays on information.


LUDWIG VON MISES

After I graduated from college in May 1970, I took a year off to learn economics on my own. Harold Demsetz of the University of Chicago had come to our school in February 1970 and given three great talks on economics that caused me to think, with some encouragement from him, that I might want to study economics as a graduate student. He suggested that I buy all the back issues of the *Journal of Law and Economics* and work my way through them. That was good advice. But it was during that year that I also read Ludwig von Mises's *Human Action* from cover to cover. I liked it a lot, but not as much as I liked Hayek. I found his tone at times offputting. But also I didn't buy, to the extent Mises did, the a priori nature of economics. Some of it is; some of it isn't.

One thing I was looking for at graduate school was a place where Austrian economics was taken seriously. I still remember how I put it in my letter: "I want, when I mention Mises, not to have my listener think I'm mispronouncing the name of a childhood disease."

I found striking, though, how little academic economists knew about Mises and Hayek. That was a disappointment to me. In February 1972, when I was at the University of Western Ontario to take a year of advanced undergrad and one graduate class in economics, I was accepted with a reasonable money offer to UCLA. Shortly after, Armen Alchian wrote me to tell me why I should come to UCLA. I felt honored but also felt confident enough, in my letter back to him, to tell him that one thing I was looking for at graduate school was a place where Austrian economics was taken seriously. I still remember how I put it in my letter: "I want, when I mention Mises, not to have my listener think I'm mispronouncing the name of a childhood disease." I don't think Armen answered, but I did end up going to UCLA and it was a good decision. Unfortunately, there was scant mention of Austrian economics except for one thing: In many of the syllabi the first year, one of the readings was Hayek's article "The Use of Knowledge in Society."

In the spring of 1974, I was invited to the first Austrian conference in South Royalton, Vermont. There I interacted with Murray Rothbard, Henry and Francis Hazlitt, Israel Kirzner, Milton and Rose Friedman (who crashed the party before the opening dinner), William Hutt, Svetozar Pejovich, and many young fellow economics graduate students such as Mario Rizzo, Randy Holcombe, Roger Garrison, Richard Ebeling, and a number of others. That deepened my interest in Austrian economics and I decided to learn more. (Incidentally, one of the few pieces of bad advice I was given by my mentor, Harold Demsetz, was not to go. I'm glad I went against his advice.)

In my last year at UCLA, 1974-75, when I was supposed to be working on my dissertation, the intellectual experience that I enjoyed most was the meetings

"That's when I first became impressed with Mises as a giant of an economist."

of our Austrian study group at George Smith's apartment. The regular attendees were George Smith (who had written a book on atheism), Tom Palmer, John McCarthy, fellow Canadian and UCLA econ graduate student Harry Watson, the late Dianne Peterson, and I. We started with Mises' *Theory of Money and Credit,* with each person being responsible for preparing a presentation on a chapter and the rest of us being responsible for reading the chapter carefully. That's when I first became impressed with Mises as a giant of an economist. I especially liked the tone of the material written in 1911, which was most of it. He treated those he disagreed with as smart economists who had made errors. I think one could do worse than use *Theory of Money and Credit* today as the main text in a graduate monetary theory course, supplemented, of course, with many modern articles.

After we finished Mises, we went on to Hayek's *Prices and Production.* That book made sense to me as an analysis of business cycles only if one rejected the idea of "rational expectations," an idea that I was starting to find compelling.

In June 1975, when I attended the second Austrian conference in Hartford, Connecticut, I went up to Hayek, who was attending, and said to him, "Professor Hayek, your analysis in *Prices and Production* makes sense to me only if we reject rational expectations. Do you agree?" He winced and went on to disagree but I still don't understand what he said. (By the way, when Hayek's cab pulled up on the Sunday afternoon before the conference started and the driver pulled Hayek's large suitcase out of the cab, I looked at a group of fellow graduate students who were more into Austrian economics than I was, figuring one of them would offer to carry his suitcase up the narrow stairs. None of them did, and so I went up and offered to do so. Hayek accepted gracefully. That suitcase was heavy. On the way up the stairs, I said, maybe a little too impudently, "This is heavy; what have you got in here?" Hayek chuckled and answered, "Books.")

"I thought that in many of those cases I could do an article that was almost as good as, or occasionally better than, the one by the bona fide economist."

My bottom line is that I have learned a lot from the Austrian school but I wouldn't call myself an Austrian, just as I've learned a lot from the neoclassical economists, but would not call myself a neoclassical. My friend Jeff Hummel put it well: "When I talk to Austrian economists, I feel like a neoclassical; when I talk to neoclassical economists, I feel like an Austrian." That's my view too.

LMR: Among your list of accomplishments, you often write the *Wall Street Journal* article when a new Nobel winner is announced in economics. How did that happen?

DRH: I noticed that when the Nobel prize was announced early Tuesday morning (in the last 15 or so years the announcement has been on Monday morning, Columbus Day), the next day's *Journal* would have a Review and Outlook (the *Journal's* category for editorials written by members of the editorial board) editorial briefly mentioning one of the economist's (or economists') insights, linking it to some policy issue that interested the *Journal's* editors. It was only on Wednesday that there would be an op/ed by an outside economist who really knew the prize winner's (I'll use singular from now on) work. That meant that were was a 48-hour gap between the announcement and a first-rate article on the economist's work.

I thought that in many of those cases I could do an article that was almost as good as, or occasionally better than, the one by the bona fide economist. I had written a few op/eds for the *Journal* and so I approached one of the editors of that page with whom I had dealt (this was just before I began using email and so I think I wrote him) and made the following offer: I will get up at 4:00 a.m. Pacific time, turn on CNN, and see who won the prize. Then I will contact you

"What I learned was that I was hearing from incredibly biased sources—both about World War II and about the Cold War."

by 5:00 a.m. (8:00 a.m. Eastern time) and tell you whether I can do it. I won't mislead you. If I can't do it, I will tell you. Then I will have it done by 3:00 p.m. Eastern time.

The editor accepted. That started in 1996. That year the prize went to James H. Mirrlees and William H. Vickrey. I was elated. I remembered that I had read Mirrlees's finding that even a redistributionist-minded government should set the top marginal tax rate at about 20 percent and I had a textbook by Vickrey in which he had advocated, many years earlier, tolls for roads that varied with time of day and even envisioned something thought silly at the time, little meters in your car that could communicate with transmitters and receivers at the toll booths so that you wouldn't have to line up to pay your toll. So I knew I had my article. I contacted the editor before 5:00 a.m. to say I was in. I went to my office at the Naval Postgraduate School to get my Vickrey book and then headed to the downtown Monterey office I rented to find the Mirrlees material and start writing. My wife is a professional editor and so, after finishing the article at around 11:00 a.m., I faxed it to her and had her edit before 11:30 a.m.

That started a long tradition. I have done it 17 out of the last 22 years. In three of the years I missed, 1999, 2000, and 2002, I was traveling in Europe. In the other two years I missed, 1998 and 2007, I didn't know enough about the economists' work.

Three main things have changed in the last 15 years: (1) the announcement time, (2) the *Journal's* deadline, and (3) access to information on the web.

"Here's how I decide: the bar for me to write a negative piece is higher than the bar for me to write a positive piece. If I'm criticizing someone on 'his day,' I'd better know the work pretty thoroughly."

The announcement time was gradually made earlier; it is now about 2:45 a.m. Pacific time. So I set my alarm for about 3:30 because I will know within an hour of waking whether I can do it and even on New York time the *Journal* editor is not functioning at 7:30 a.m. Also, because of the increasing importance of the European edition of the *Journal,* the editors like to get the article by 11:00 a.m. Pacific time rather than noon. Finally, the information on the Nobel site, plus information from that encyclopedia known as Tyler Cowen, as well as information from Alex Tabarrok (both on the economics blog Marginal Revolution) have made my job easier. Indeed, a tradition that I started about 5 or 6 years ago was to send an early draft of my piece to Alex Tabarrok, who always gets back to me within half an hour and always with good suggestions for improvements.

One interesting story from 2014 involves Alex. That was the year that Jean Tirole was awarded the prize. I watched the explanation of the Nobel committee guy live on line. He emphasized Jean Tirole's work on reining in large firms. A friend who noticed that I was on Facebook messaged me to say that if I was

doing the piece this year, he had some thoughts to share on Tirole's work in which Tirole comes off as a central planner. After reading Tyler Cowen's and Alex Tabarrok's excellent, and almost immediate, posts on Tirole, I decided that I didn't know enough about Tirole to write the piece. Here's how I decide: the bar for me to write a negative piece is higher than the bar for me to write a positive piece. If I'm criticizing someone on "his day," I'd better know the work pretty thoroughly. That's why I didn't write the piece on Amartya Sen when he won. I had never been impressed by his work, and my piece would have been very critical; but I thought I might have left something positive and important out.

I called Alex Tabarrok and discussed the idea, and told him that if he wanted, I would bow out and recommend him. Alex didn't feel comfortable enough either. I then called my editor at the *Journal* and told him my thinking. His thinking was similar to mine: if you're going to say it was a bad pick, you had better really know the work.

Two minutes after I called my *Journal* editor, Alex sent me a 2003 article by Tirole and Jean-Charles Rochet that turned around my thinking on Tirole. It's the one I quote in my *Journal* piece. I looked back at everything I had seen that morning and realized that it was the Nobel Committee, with its emphasis on reining in big business, that had colored my view of Tirole. That wasn't fair to Tirole. But it also gave me my angle: contrast Tirole's cautiousness with the Committee's aggressiveness. I e-mailed the two *Journal* editors I was dealing with, titling the e-mail "HALT." I made my case. The *Journal* accepted.

LMR: Among economists in the U.S., you are a rare commodity in that you worked in the Reagan Administration, you taught at the Naval Postgraduate School, and yet you also tend to be quite a "dove" on foreign policy. In fact you've recently been giving lectures about the role of economists in ending the draft. Can you share your thoughts on these topics?

DRH: Sure. My "doveness" preceded my time in the Reagan administration. I grew up in English-speaking Canada where pretty much everyone was a Winston Churchill fan, believing, as we did, that he saved Western civilization from Hitler. When I moved to the United States in 1972, I was a Cold War hawk. But two people whom I met in the 1970s—the late Roy A. Childs, Jr. in 1973 and the late Ralph Raico in 1975—affected my thinking on foreign policy, and Ralph especially affected my thinking about Churchill. It was a steady drip, drip, drip as they challenged my thinking and also suggested various things to read. What I learned was that I was hearing from incredibly biased sources—both about World War II and about the Cold War. I hadn't known, for example, basic facts like the fact that the number of Soviet citizens killed during World War II was over 60 times the number of Americans killed. That, in itself, is not an argument for a non-interventionist foreign policy, of course, but it was one of those important facts that can affect one's thinking about both World War II and the Soviet menace. Important in this also was my earlier reading of the work of the late G. Warren Nutter, whose work challenged the idea that the Soviet Union's economy was a colossus. I had read that long before having met Roy or Ralph. Bit by bit, I came to believe that the Soviet Union was not that much of a threat to us and that even if it was a threat with nuclear weapons, our government didn't need to be involved in NATO or in Japan or Korea because those countries had ample resources to defend themselves.

The other major influence on my foreign policy thinking was David Friedman's book *The Machinery of Freedom.* His chapters on foreign policy convinced me that even if it was important for the U.S. government to intervene to head off nasty governments, the odds that government officials would do it well were slim.

"My most influential article in the Wall Street Journal, the one in August 1990 that said that, contrary to Henry Kissinger, Secretary of State James Baker, and President George H.W. Bush, Saddam Hussein could not cause a huge loss in U.S. GNP."

So when I entered the Reagan administration in 1982, I was already pretty much a non-interventionist. That didn't matter much for my work because I was dealing with almost solely domestic economic policy. Working under Martin Feldstein and the late Bill Niskanen at the President's Council of Economic Advisers, I was the Senior Economist for health policy from 1982 to 1984 and the Senior Economist for energy policy from 1983 to 1984. Incidentally, I think Bob Murphy will find it interesting that in my first year there I had as colleagues his favorite economist, Paul Krugman, as well as Larry Summers, Greg Mankiw, and John Cochrane. The closest I came to foreign policy was in concluding, when I had the energy slot, that because oil is fungible, the oil weapon was a dud. Indeed, that thinking and some estimates I put to it, were behind my most influential article in the *Wall Street Journal,* the one in August 1990 that said that, contrary to Henry Kissinger, Secretary of State James Baker, and President George H.W. Bush, Saddam Hussein could not cause a huge loss in U.S. GNP. Richard Harwood, an editorial writer for the *Washingon Post,* wrote an editorial a few days later giving me credit for creating quite a stir in D.C.

To give you an idea how focused I was on the job at the Council and not paying attention to foreign policy, one of my best friends called me one day to complain about CIA chief William Casey mining the harbor of Managua, Nicaragua. I replied, "He did?" I literally didn't follow it, figuring my best strategy was, kind of like McGruff the crime dog, to do my best each day to take a bite out of government.

How did I get to the Naval Postgraduate School? That's not an obvious move for someone with my views on foreign policy. It has to do with my marriage. I got married in August 1983, halfway through my time at the Council, and my wife badly wanted to move back to the San Francisco area, where we had met two years earlier. I told her that I would interview for every plausible job between

"I have met so many fine people in the U.S. military and in foreign militaries who are naturally curious and relatively easy to teach. I still get letters from people who were my students."

Marin County in the north and Carmel in the south, but I would also need a Plan B in case no good job in that area came through. I happened to mention to a friend who was a Commander in the Navy, for whom I had done a favor when I was on the faculty at the University of Rochester, that I wanted a job in that area. He told me about the Naval Postgraduate School. I contacted the chairman of the department that contained the economics group and my friend had already called him. The chairman was gung-ho on hiring me, and, as I learned later, was one of the few votes in my favor. So, I realized pretty quickly after getting there, that, with a baby on the way in a few months, I should try to win them over. I did.

I've never regretted my choice. I have met so many fine people in the U.S. military and in foreign militaries who are naturally curious and relatively easy to teach. I still get letters from people who were my students, one, three, five, ten, and twenty years ago in which they tell me how much they appreciate what I taught. One of my favorites was from an officer on a U.S. Navy ship who told me he was doing everything in his power not to start a war.

On the draft, my opposition to the draft started when I was 17 and read Milton Friedman's *Capitalism and Freedom,* and followed up with other articles

"When Senator Sam Nunn tried to bring back the draft in May 1979, I testified against it before the Senate Armed Services Committee."

and books, including the volume edited by Sol Tax that contained the papers and conference transcript from the famous conference on the draft held at the University of Chicago in 1966. (I had found a used copy for about a dollar at Coles' Books, a discount bookstore in Winnipeg.) I found the argument that the draft was a form of slavery instantly persuasive and, beyond that, found the economic argument that the draft is more costly than an all-volunteer force of the same size both clever and powerful.

Pretty much all of my experiences when I was between 18 and 19 reinforced my views. One was at a weeklong Intercollegiate Studies Institute conference at Rockford College in Illinois in August 1969 that I attended after having worked that summer in an underground nickel mine in northern Canada. The 9 libertarian students, out of about 60 who attended (the rest were conservatives), quickly bonded and two of them expressed their worry about being drafted and sent to Vietnam. That made it very real for me. Another major experience was an interaction I had with a young soldier based at Fort Lewis, whom I met in the Shelter Half, an antiwar coffeehouse in Tacoma, Washington in June 1970. His name was David Henderson. I told him he looked scared and he said he was: he was heading to Vietnam the next day. As we talked, I learned that he had grown up in a small town in North Dakota that I knew well: it was 29 miles south of the town I had grown up in in Manitoba; when I was young, our family drove down to his town to see movies on Sunday nights. That brought the draft home to me more powerfully. By the way, I was working in the Reagan White House when the Vietnam War Memorial was opened in November 1982. Almost immediately I headed over to see if his name was on the wall. Fortunately, it wasn't.

When Senator Sam Nunn tried to bring back the draft in May 1979, I testified against it before the Senate Armed Services Committee. I also spoke at some anti-draft rallies, one at Carnegie-Mellon University in May and one at UC Berkeley in October. Incidentally, the Students for a Libertarian Society paid my airfare from Rochester to Pittsburgh, and they paid it out of a generous gift from Charles Koch. There, I've said it.

In the summer of 1980, after Ronald Reagan had come out against the new draft registration law that Jimmy Carter had signed earlier that year, I wrote an economist's statement against the draft, and got various prominent economists, including Milton Friedman, Alan Greenspan (whom I had been on a panel with at the American Economic Association meetings in Denver in early September—he representing Reagan and me representing Libertarian Party presidential candidate Ed Clark), and Murray Rothbard, to sign. When it was published as a full-page ad in *Inquiry, Libertarian Review,* and *The Progressive* in the fall of 1980, it had about 140 signers. I later got about another 140.

In short, I've been against the draft for over 49 years. I doubt that that's a view I will change. I've also written and spoken about the important role that Martin Anderson, Milton Friedman, Walter Oi, and William H. Meckling (my boss at the University of Rochester) played in getting rid of the draft.

LMR: Now that you are recently retired from teaching, we understand that you have a philosophy when it comes to investing for the later years?

DRH: Yes. It's pretty simple, really. A lot of it is in one of my favorite books on the issue, *Getting Rich in America: Eight Simple Rules for Building a Fortune and a Satisfying Life,* by economists Dwight R. Lee and Richard H. McKenzie. In my review of it in the *Wall Street Journal,* I called it "the how-to guide for becoming the millionaire next door." I realized that I had been following all 8 rules for the previous 15 years and have now followed them for over 30 years.

There are some obvious steps: pay off your credit cards every month. If that's hard to do, then come up with an aggressive plan to pay them off as soon as possible, focusing the biggest payments on the highest-interest credit cards.

Once you've done that, save as high a percent of your income as you can manage in tax-advantaged funds—401(k)s, 403(b)s, SEP-IRAs, Roth IRAs, etc.—and invest a very large percent of those funds in funds like Vanguard's Total Market Index. What if, starting out, you can handle saving only 5 percent of your income? Then do it. But every time you get a raise, even just a cost-of-living adjustment, add some of that raise to the percent you save. So, for example, if you get a 3-percent raise, then increase the percentage you save from 5 percent to 6 or

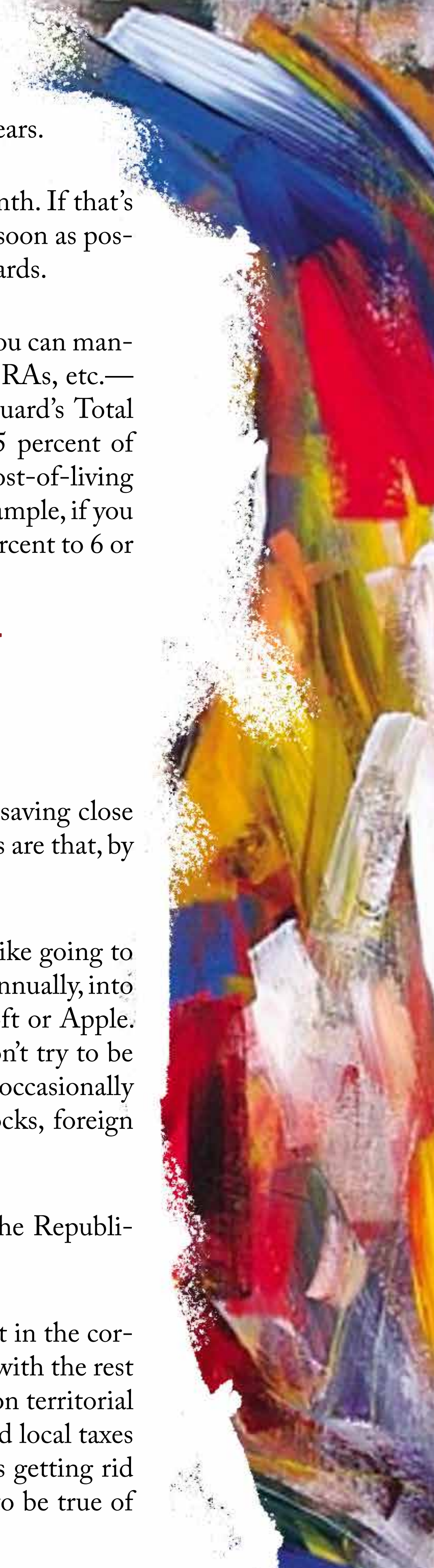
"Every time you get a raise, even just a cost-of-living adjustment, add some of that raise to the percent you save."

7 percent. Do that over a few years and, within 6 or so years, you're saving close to 15 percent of your gross income. Do that for 30 years and the odds are that, by your standards, you will be rich.

Two cautions. First, if you invest in individual stocks, treat that like going to Vegas. Don't put any of that 5 or 10 or 15 percent that you're saving annually, into individual stocks. You may think you can identify the next Microsoft or Apple. The odds are higher that you'll invest in the next eToys. Second, don't try to be a market timer. Invest your funds and keep them there. You might occasionally want to rebalance the mix of your portfolio between domestic stocks, foreign stocks, and bonds, but do that to rebalance, not to time.

LMR: Finally, what are your thoughts on the tax package that the Republicans have passed?

DRH: I think it's quite good. As I've written at EconLog, the cut in the corporate tax rate is great. The United States has been so far out of line with the rest of the world on this; also, the shift of the corporate tax rate to a tax on territorial income is great also. The $10,000 limit on the deduction for state and local taxes is excellent. The main things I dislike are what it fails to do, such as getting rid of the tax credit for getting an electric car, but that's always going to be true of



any bill that passes the U.S. Congress. The surprise is that such a good bill, with some real reforms, was passed. It's substantially better than I had expected from this Congress and this President.

The part of the bill I disliked most was the child tax credit and its "refundability" feature, which in itself is a misuse of language: you can't refund something that was never taken in the first place. The other part I dislike is that Congress didn't include more cuts in spending to keep the cumulative deficit over 10 years well under $1 trillion.

"The cut in the corporate tax rate is great. The United States has been so far out of line with the rest of the world on this."

Also, the tax bill changes the way tax brackets are adjusted for inflation. Tax brackets for most people will rise slightly over time. Given that the Congress did that, I think it should have applied the same chain indexing to how Social Security benefits are adjusted for inflation over time. That will be very hard to achieve now. I'm guessing that the various players figured, maybe correctly, that they couldn't get enough Republican votes for such a measure because Republicans were worried that a large percent of their base is elderly Social Security recipients.

I was surprised, and a little disappointed, that not one Democrat in Congress voted for the bill. My reasoning as an economist tells me that some Democrats will regret their choice, especially when over half their constituents see higher after-tax pay as early as February. My reasoning as an economist who understands political incentives tells that maybe there's something in these Democratic politicians' calculus that I've failed to take account of.

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Note: The economists and financial professionals interviewed in the LMR are given the freedom to express their views, without necessarily implying endorsement from the editors.

EVENTS & ENGAGEMENTS

NOTE: MANY OF THESE EVENTS ARE OPEN TO THE PUBLIC. CONTACT US FOR FURTHER DETAILS.

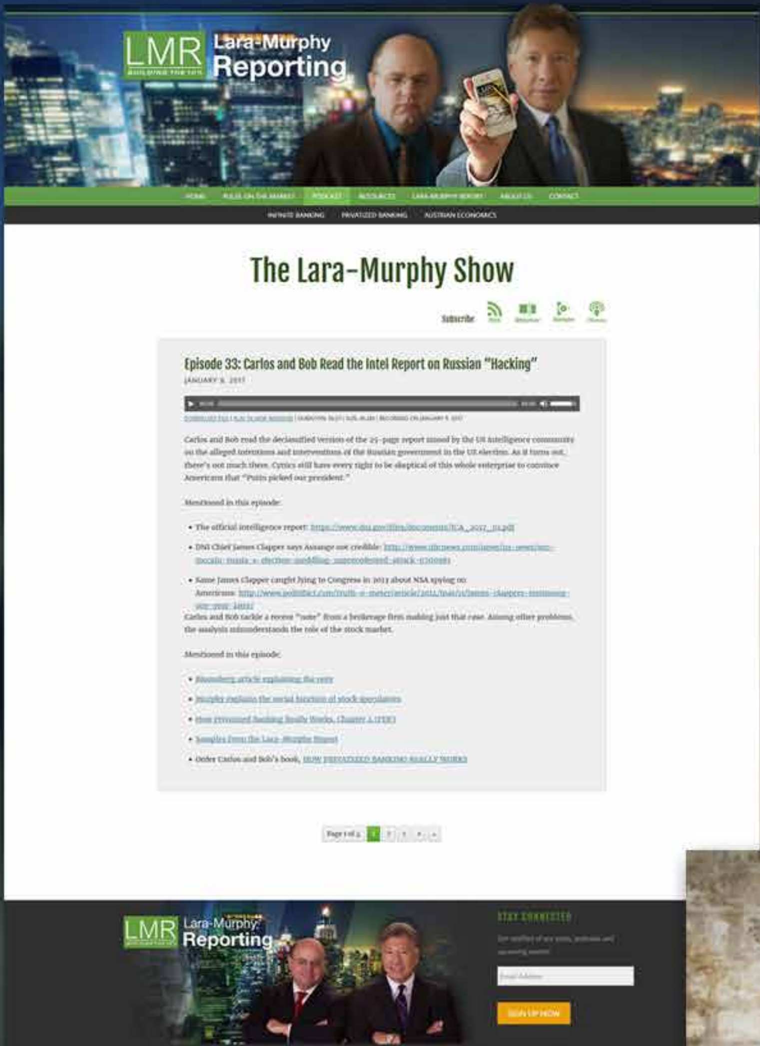
DECEMBER 9, 2017
ORLANDO, FL

Murphy and Mises Institute president Jeff Deist discuss the prospects for liberty. Details at: https://mises.org/events/bob-murphy-uncertain-prospects-liberty

FEBRUARY 10, 2018
BIRMINGHAM, AL

Nash, Lara, and Murphy present the IBC Seminar for the general public.

SOME EVENTS MAY BE CLOSED TO GENERAL PUBLIC.
FOR MORE INFORMATION: LMREVENTS@USATRUSTONLINE.COM



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