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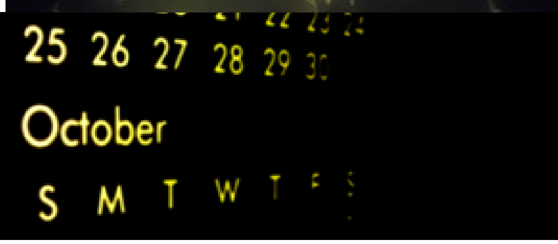
Overview



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ABOUT LARA & MURPHY

L. Carlos Lara manages a consulting firm specializing in corporate trust services, business consulting and debtor-creditor relations.

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

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

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

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

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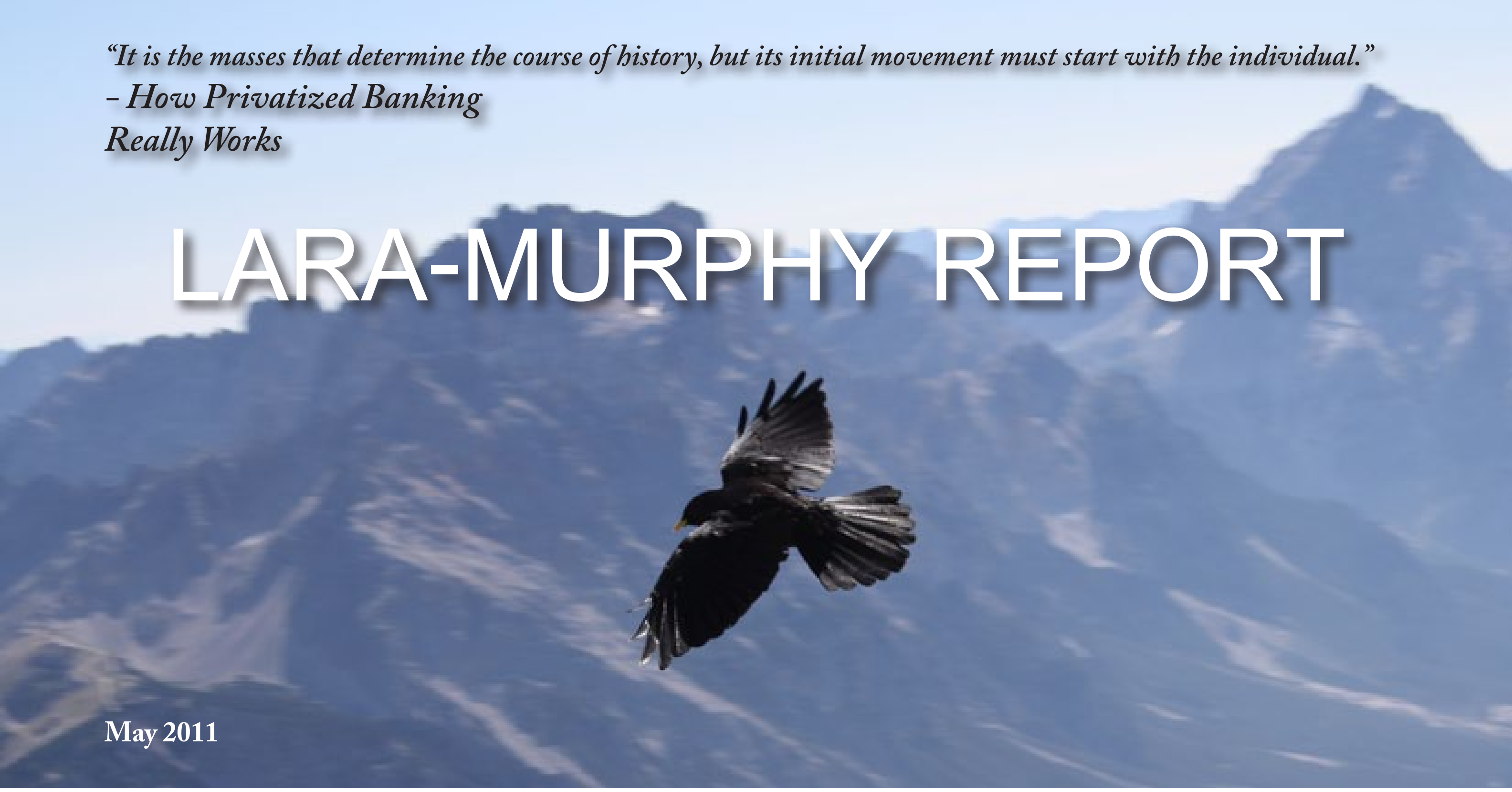
"It is the masses that determine the course of history, but its initial movement must start with the individual."
– How Privatized Banking Really Works

LARA-MURPHY REPORT



May 2011

Dear Readers,

One of the more significant facts of history is that ultimately all governments collapse. We know this to be true by simply using the vantage point of history. If we take the time to examine the past we find that every government, which has failed and disappeared has followed the same course of events. Governments, with their insatiable appetite for power, invariably increase their encroachment on society and monopolize everything within their grasp. The economy, which they rule and regulate, cannot help but suffer in the wake of this intensifying control. Consequently, production diminishes slowing to a crawl. A state arises in which there is less and less available for government to confiscate to keep it alive. Eventually government is hit by some immediate circumstance or situation that it cannot escape and it implodes. What is critically significant is that preceding this last event the cultural and moral values of the people have deteriorated. They simply stop caring. In effect, society collapses and brings government down with it.

The Romans in their day were not aware of the *"decline"* of society and did not worry about the *"fall"* to which they were heading. The facts reveal that its society caved in first and there was no disposition left to resist the invading hordes. This analogy that we are drawing to our own modern day government and society suggests a prophecy that is unsettling. Nevertheless, there is no way for government to avoid these circumstances unless it abandons its course of intervention, which its inherent avarice for power will not allow.

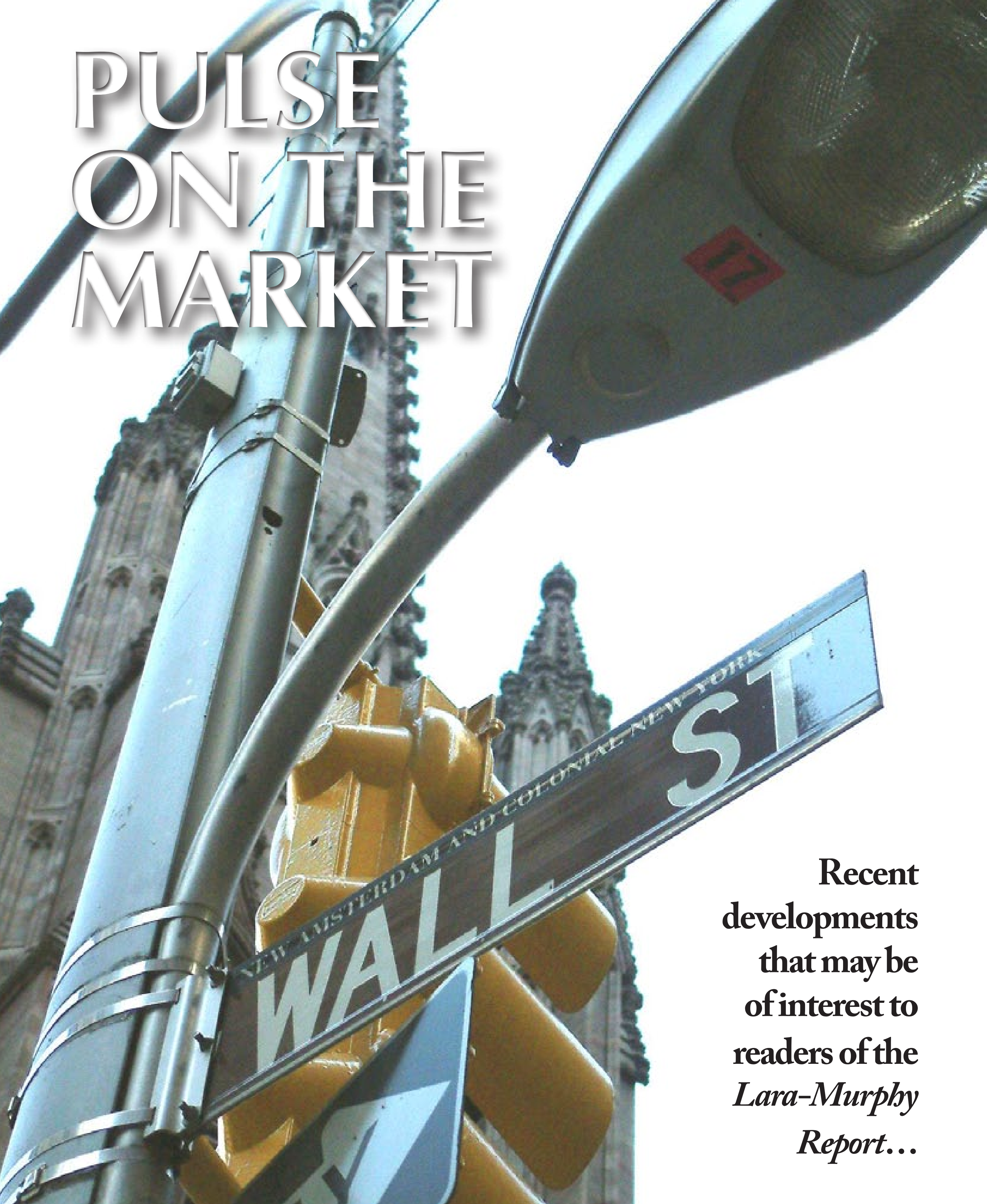
Does this mean that there is no hope for a good society? Even though our government has gone far in establishing its dominance over society there is still the dream of *freedom* in America. In this country, unlike any other, it is still possible to stop the progress of government by invoking this tradition before it completely overtakes us. It is certainly worth a try.

We are committed to reviving this enthusiasm for freedom and we know that you are too. We must not forget that the *will* for freedom comes first before freedom itself.

Yours very truly,

Carlos and Bob

PULSE ON THE MARKET



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

The Ultimate Insiders Don't Like Competition. This month billionaire Raj Rajaratnam, the founder of hedge fund Galleon Group, was convicted on 14 counts of securities fraud and conspiracy, aka "insider trading." Beyond the general problem of the government trying to punish people for profiting from specialized knowledge—which is the mechanism through which market prices incorporate the dispersed knowledge held by everybody—is the disturbing fact that the Rajaratnam case heavily relied on wiretaps. This is a new development in a securities case, and will probably provide a precedent for the government to eavesdrop on more financial players. Ironically, a new academic study by Ziobrowski et al. has come out, showing that from 1985 to 2001, members of the U.S. Congress beat the market by 6% annually in their personal investments, presumably because they had advance knowledge of legislative decisions that would affect returns. But don't worry, they didn't break any laws—the Securities and Exchange Act banning insider trading specifically exempts members of Congress.

LUCK OR MANIPULATION

Speaking of Bending the Rules… The United States Treasury has *already* exceeded its statutory debt limit; it broke through the ceiling in mid-May. At this point, Treasury Secretary Geithner is playing accounting games to keep the game running. Specifically, there are several funds (such as pensions for retired federal workers) that currently own large holdings of Treasuries. When some of the specific securities mature, the Treasury now won't actually roll them over by issuing new securities to replace them. Instead, Geithner will allocate the "freed up" room to take on new debt, and will separately keep track of how much the Treasury owes to the pension fund. By such tricks as these, Geithner can limp along until early August. Our position is that Uncle Sam should do what any cash-strapped business does in a similar situation: Cut spending and sell off assets. The government is sitting on trillions of dollars of wealth in the form of gold, oil (both in the Strategic Petroleum Reserve and buried under the ocean floor and Alaska), and real estate. It's simply not true that Congress needs to raise the debt ceiling in order to avoid an explicit default on outstanding debt.

FEDERAL OVERDRAFT

Baby Steps to the Sound Money Solution? This month Utah became the first state to officially sanction gold and silver coins as currency. There are similar bills pending in other states. The action doesn't counteract the "legal tender" status given to paper fiat dollars, but it's a healthy step on the way back to sound money. We'll watch these developments closely and see if the feds try to arrest the process.

UTAH

Gold and Silver Coins May Be OK, but Don't Mess With the TSA. In contrast, the federal government was *not* happy with a proposed Texas "anti-groping" law that would have made it a misdemeanor to touch the private parts of another person. Although that sounds innocuous enough, the controversial part was that the Texas legislature intended the law to apply to TSA agents. In response, the government told the Texas legislature that if they went forward and passed the bill, and the feds couldn't delay it through any other procedure, the TSA would simply ban all flights out of Texas, since it couldn't otherwise guarantee safety. Neither of us is a lawyer, so we can't comment on the actual legality of the controversy and how federalist principles apply specifically. But in general, this shows the danger of granting large amounts of power to the federal government. If the feds want to, say, get a state to change its speed limits—what should be a local affair—then they can simply threaten to withhold federal highway funding. And in this case, if a state wants to protect its citizens from groping at Texas airports, the feds can literally impose blockade of air travel out of the state. It's precisely for this reason that "national health care" is such a terrible idea. Even putting aside problems of quality of care and cost, we don't want the government to have yet one more massive tool of leverage over average people.

TSA REACHES OUT

Mr. Murphy Goes to Washington. On May 25, one of us testified before the Subcommittee on Oversight and Government Reform on the connection between Fed policy and oil prices. It was particularly interesting when Rep. Dennis Kucinich (D-OH) asked Murphy whether he would support returning control of the Fed directly to Congress, instead of its current quasi-private status where it is influenced by bankers. Murphy suggested instead that the Fed be abolished altogether, and reminded Kucinich that we didn't always have a Fed.

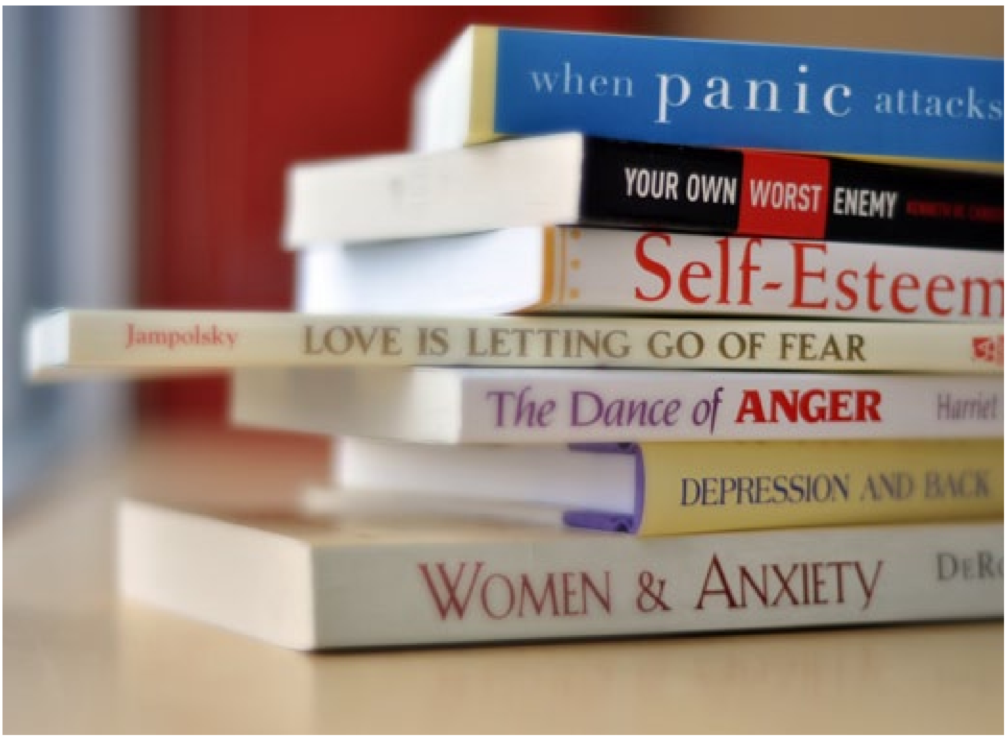
BOB UP HILL


THE
IBC
SOLUTION

BY L. CARLOS LARA

Life, as we all know, is difficult. Each of the twenty-four hours of every day is filled with uncertainty and a host of stress filled problems of one kind or another. In fact, the demand for stress relief from life's problems is so large that it has spawned a multitude of billion dollar industries. The books, articles, and studies that have been written on the subject of human anxiety are innumerable going as far as categorizing and ranking our fears from the least to the greatest. Not surprisingly, what we find when we read these reports is that the greatest fears center mostly on money issues. Even above the fear of death is the fear of being without money or the lack of financial security. Ask the average American to list his greatest fear and almost one hundred percent of the time the fear of impoverishment tops the list.

These facts present a unique situation for financial professionals. After all, these are the men and women who speak to people about their money and do so in an advisory capacity. In 2011 the greatest fear that people are known to have, the fear of financial ruin, is now at its highest peak. Consequently, financial professionals are faced with the daunting task of helping clients navigate through the most devastating financial crises in history. This is an awesome responsibility with critical consequences hinging on the advice that is given. Since the financial crisis, which started in 2008, huge losses have been suffered by millions of individuals either by way of the stock market's erratic behavior, or by the collapse of the housing market. Many have lost their jobs and remain unable to find employment. Countless others have lost their businesses and have gone broke. Today, there seems to be nowhere left to put one's money where it safe. For the older generation, there is the ever-present fear of running out of money while the younger generation worries about how they will ever be able to save any money at all. The result is a nation of people who are skeptical, cynical and mistrusting. For this reason the general public is showing an interest in economic affairs that has not surfaced in decades. People everywhere are paying greater attention to issues dealing with monetary policy and are eager to learn simply because they are in such financial turmoil. Americans need a financial professional who is able to accurately explain to his clients the causes of the financial crisis, its current state and a way of escape. In order to be able to do this, the financial professional must know, unequivocally, that an accurate economic analysis can be found only in an education in Austrian economics.



In this article we want to focus on three fundamental economic explanations that can help financial advisors provide the advice their clients most need right now. These are **inflation**, **the Federal Reserve** and **Privatized Banking**. Two of them explain the core problem and the third is the solution.

Photo on left from Flickr by: gregwest98

Inflation

One of the most basic pieces for understanding the cause of our current crisis is to have a complete and accurate definition of *inflation*. Armed with this correct understanding, the financial professional can open the mind of a client who has been misled by the traditional definition of inflation as simply the increase in prices. The client needs to hear an accurate explanation of why and how prices rise. Without this proper understanding the money dilemma can never be deciphered and remains a mystery. An understanding of savings, investments, rates of interest and returns become untenable without this proper explanation. Once again, only Austrian economics provides the true meaning. If the financial professional can accurately explain that inflation is a form of *indirect tax* he becomes rare among his peers. If he can demonstrate to his clients that the tax is hidden and why, he will certainly be set apart from the rest of the professionals in the financial services industry. The client will soon realize that he is in the presence of someone who truly understands how the economy works. In effect, what the advisor will be exposing is that inflation is deliberately set in motion by the few in power at the expense of everyone else in society. He is exposing a practice that is not only morally wrong, but, if continued, will ultimately destroy the economy itself. The importance of this cannot be overstated. Not only because inflation is so disastrous to the client's own situation, but by the simple fact that only one man in a million is aware of it. Ludwig von Mises, the greatest member of the Austrian School of Economics in the 20th century explains it this way:

Everything that is being done by a government against the purchasing power of the monetary unit is, under present conditions, done against the middle classes and the working classes of the population. Only these people don't know it. And this is the tragedy…

What I want to point out is that the greatest problem today is precisely this, although the people don't realize it. The danger is due to the fact that people consider inflation as something that hurts other people. They realize very well that they too have to suffer because the prices of the commodities they are buying go up continually, but they don't realize fully that the greatest danger for them is precisely the progress of inflation and the effect it will have on the value of their savings.

…We should not forget that over and above the consequences of destroying a country's monetary standard, there is the danger that depriving the masses of their savings will make them desperate. (1.)

The Federal Reserve

Let's be clear. Inflation is the increase of the money supply. High prices are the *effects* of the increases in the quantity of money. More money in circulation simply lowers the value of the money and bids up prices on everything. The net result for society is always disastrous yet the process of inflation has been around since the first coin was minted. Every time inflation is mysteriously set in motion it creates distress and confusion among the people.

The word "inflation" originally applied solely to the quantity of money. It meant that the volume of money was inflated, blown up, overextended. It is not *mere pedantry to insist that the word should be used only in its original meaning. To use it to mean "a rise in prices" is to deflect attention away from the real cause of inflation and the real cure for it.* (2..)

Who or what sets inflation in motion? Long ago Caesar began inflating the Roman coin when he first discovered that tax revenues were insufficient to pay for all of Rome's expenditures. To solve his deficit problem, Caesar resorted to clipping the edges of the coins in order to make more coins. He debased and increased the money supply to solve his problem, but did it at the expense of Roman society. In our modern times the federal government and the Federal Reserve employ the same basic mechanism used by Caesar: In addition to what the government spends through direct taxation and borrowing (bonds) from the private sector, the government also finances some of its purchases through the creation of new money supplied by the Federal Reserve. The process is not as overt as Caesar's methods, but the underlying economics are essentially the same. All holders of dollar bills ultimately pay the cost through the hidden tax of rising prices. In other words, in addition to their direct tax payments and whatever money they directly lend to the government by buying Treasury bonds, the public also pays in the form of the rising cost of living.

The financial advisor must be ready to explain how the government justifies this massive transfer of wealth from the public. The answer, of course, is Keynesian economics. Made famous by John Maynard Keynes in 1936, Keynesian economics actually advocates the increase of deficit spending (borrowing). According to his theory, and one that politicians enthusiastically embraced, *spending* could boost aggregate demand and would eventually lead to the elimination of unemployment. The implication is that if only we could have Christmas everyday of the year, we would never have recessions. In the Keynesian view, the old-fashioned virtue of thrift—living below one's means—is positively harmful during a recession. This, of course, is just the opposite of what we should be doing. Nevertheless, whether liberal or conservative, our universities and financial press today are thoroughly infused with the Keynesian mindset. This is precisely why we see the Federal Reserve continuing the creation of more money (quantitative easing). An economy that is already on its knees is taking further blows and having more of its resources siphoned away from the productive sector by an inefficient political process.

Once the financial professional is able to understand the basic mechanics of inflation and can relay them over to his clients, they in turn will able to see why politicians are so reluctant to cut spending and balance the budget. Unlike a private household or corporation, there is no danger of insolvency for the government, so long as it can rely on the Federal Reserve to create new dollar bills. Of course greater inflation of the

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money supply will lead to rising prices and soaring interest rates, and so the Federal Reserve must exercise some restraint. Nonetheless, the overall trend is clear: the government is making no real effort to pay off any of the mounting debt which now stands at over 14 trillion, and is seeking legislation to borrow even more. This symbiotic relationship that exists between the Federal Reserve and our political system has led us to the brink whereby the U.S. dollar could actually collapse. Is there no way out of this madness?

Privatized Banking

What if there was a solution? Would your client hesitate one moment in wanting to know the answer? Of course not! No one would. Here is where the financial professional makes the case for the *Sound Money Solution*.

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.[3.]

The obvious cure for rampant price inflation and economic crises is to remove political interference from the institutions of money and banking. When money is once again a commodity produced by the market, and when bankers receive no special privileges exempting them from their contractual obligations, people will once again be able to lean heavily on a stable medium of exchange for their financial planning. We will have *sound money*. However, a society can only return to sound money when enough people demand it of their government. That is why education is the first and most important step—people need to understand the importance of sound money, and the dangers of fiat money and central banking. Everyone knows our current financial system is sick, but only people steeped in Austrian economics can offer the correct diagnosis and cure. Unfortunately, there are also many powerful people and institutions who benefit from the status quo. But, the practical suggestions for how our society could move, bit by bit, back towards the ultimate goal of complete freedom in money and banking are frequently recommended by those who understand the lessons of the Austrian economists.


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Step one of the Sound Money Solution is to tie the dollar back to gold. The reason this is such an important first step is because it stops inflation. Gold cannot be inflated like paper bills. The second step is *privatized banking*: return the institutions of money and banking back to the private sector. The most important result of this step is that the nation's purse strings are removed from the grasp of government officials and big banks. If step one and step two can be accomplished then there would be no need for a central bank; step three would eliminate it. In his book *End the Fed* Ron Paul spells out that our current financial system is untenable as he explains:

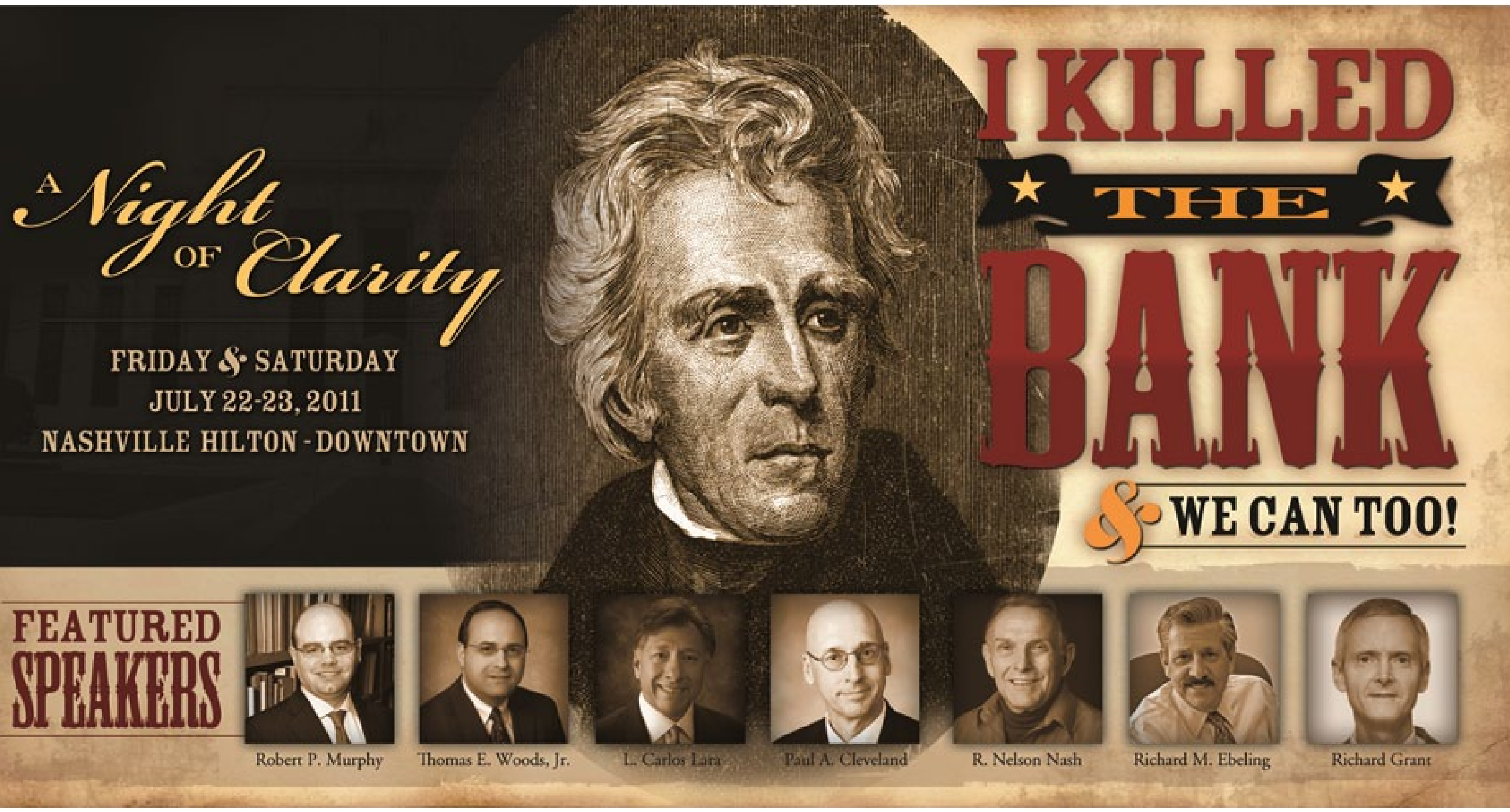
There is another path, but it requires a complete turnaround. It requires only the political will to *unplug the machinery of the Fed. Contrary to what people might think at first, this will not mean an end to the financial system, as we know it. In a post-Fed world, we will still have the dollar, banks, ATMs, online trading, Web-based systems of fund transfer—none of this is going anywhere…*

When we unplug the Fed, the dollar will stop its long depreciating trend, international currency values will stop fluctuating wildly, banking will no longer be a dice game, and financial power will cease to gravitate toward a small circle of government-connected insiders.(4.)

Without the Federal Reserve continuing to expand the money supply and grow the size of government, our national expenditures would be greatly reduced. Our taxes would necessarily come down. This in turn would allow our savings to go up: since it is savings that fuels investments, production and a healthy economy would return.

Obviously, government officials will only relinquish their vast powers in this realm when public opinion demands it. Therefore, we need more people behind our effort. Fortunately, the return to sound money does not require the "conversion" of the entire population, or even a majority. Many Austrians believe that if they could reach just a solid 10 percent of the population, especially from key positions in academia, the media, and the business community, then this group could turn the tide. This is why the role of the financial professional is so important. Once he discovers that the Infinite Banking Concept (IBC) provides a powerful contribution to the Sound Money Solution while at the same time helping each of his clients, the goal of reaching the 10 percent actually becomes possible.

The Sound Money Solution's key action is in Step 2—*Privatized Banking*. Nelson Nash, the originator of the IBC concept, discovered that a traditional, centuries old, financial product—dividend-paying whole life insurance—can be used to immediately implement a form of privatized banking, one household at a time. Equally important, when major purchases are financed through



whole life policy loans, this does *not* expand the money supply. This is a crucial point that should not be taken lightly. Nash has shown that the proper use of dividend-paying whole life insurance could eventually allow someone to "become his own banker," meaning that he could obtain his lifetime financing needs (for cars, children's education, retirement income, and even house purchases) from policy loans and dividend payments, rather than from traditional banks or other lending institutions. This means that the bondage under the current debt-based system can finally be broken and Americans will not be nearly as vulnerable to the credit whiplashes unleashed by the Federal Reserve. In essence, whole life insurance can allow Americans to effectively secede from the current fractional reserve banking system. Unlike other potential strategies for "starving the beast," the practice of IBC makes sense at an individual household level, in *addition* to its social benefits of muting inflationary credit expansion.

What is amazing is that a revolution or uprising is not required in order to change the insanity of the world around us. It can be implemented regardless of what government and the politically connected are doing right now. There is no need to picket the streets, hold huge rallies, or storm Washington demanding changes. Not a single shot needs to be fired. This solution's only requirement is the action of a single person acting in a manner to help only himself, but in so acting ultimately he helps all of society. It is the most natural and innocent action a human being can do, and yet the idea is so powerful that as it spreads from one individual to another, a massive movement silently develops and gains velocity. Once it spreads to the masses, nothing will be able to prevail against it! Government and destructive monetary policy will be forced to change. History will be recorded differently.

Conclusion

The financial professional who is versed in Austrian economics and is himself an IBC practitioner plays a pivotal role in spreading the message and building the 10 percent. As more households begin practicing IBC, we will see three major effects: First, the idea of Privatized Banking—one of the planks in the Sound Money Solution—will seem less farfetched. Second, a growing number of households will become financially *independent*. Third, as more people add sizeable life insurance policies to their long-term financial plans, the public agitation against inflationary policies and deficit spending will be stronger. A portion of the nation's financial resources will be transferred out of the volatile commercial banking sector and into the conservative, solid insurance sector. The practitioners of IBC will find it in their great personal interest to aid the Austrians and other champions of sound money, because the value of their insurance policies would be enhanced with a stronger dollar.

All this requires *action*. Not only does the switch to insurance financing make sense at the individual level, but it also contributes to the ultimate solution—to remove government intervention from money and banking altogether. The thing we must never forget is that it is the masses that determine the course of history, but its initial movement must start with the individual. That means you and me.

The IBC Solution
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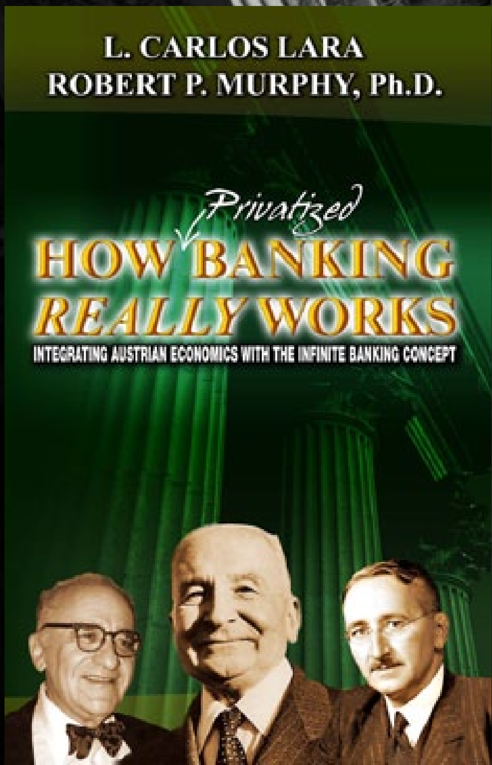

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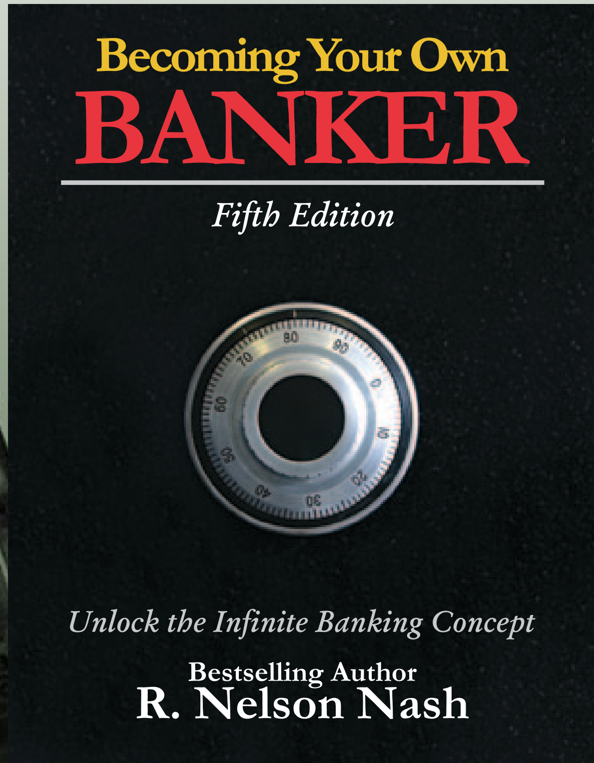

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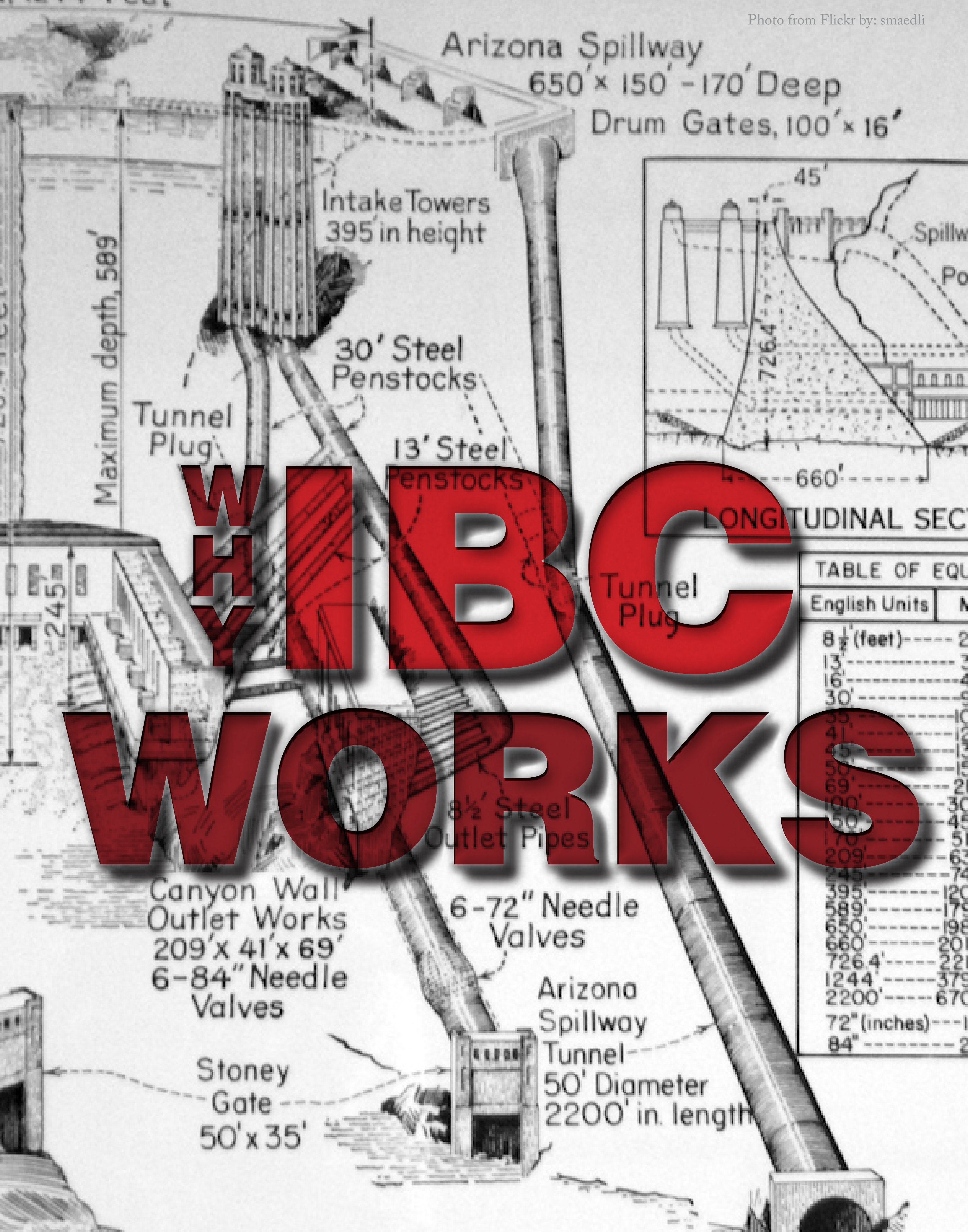
WHY IBC WORKS



BY DR. ROBERT MURPHY

When people first hear about the advantages of the Infinite Banking Concept (IBC), a typical reaction is to say, "That's too good to be true."

For example, the IBC agent might tell his or her client that in order to take out a loan against the cash values in a whole life policy, the policyholder simply needs to call the insurance company up and tell them the amount and the address. The person on the phone won't ask what the loan will be used for, what the income of the borrower (i.e. policyholder) is, what other assets the person might have to serve as collateral, and what timeframe the person intends to take in paying back the loan. Nope, the insurance company employee will simply take down the information and the check might literally go out in the next day's mail.

In contrast, try pulling the same stunt with a commercial bank or credit union. Even when applying for a secured loan, with (say) a house with lots of equity serving as collateral, a borrower will need to jump through all sorts of hoops and fill out a few forms before getting approval. The process could be quite time consuming, even for someone with impeccable credit and sizable assets.

So are the IBC agents simply lying? And if not, what gives? Are the insurance companies staffed by magic elves while the banks are staffed by grumpy trolls?

No, the IBC agents are not lying. I personally have taken out several policy loans, and have seen firsthand just how easy the process is. At the same time, I have also tried at several points to obtain lines of credit from different commercial banks, and the process is a serious hassle. I can thus verify the amazing descriptions of IBC painted by its enthusiastic fans.

As an economist, I can also explain what's going on. The difference in the treatment given clients by insurers versus conventional lending institutions is the nature of the underlying *collateral* on the loans. Once we understand how a whole life policy works, and what a policy loan really is, then it becomes obvious why the insurer doesn't have the policyholder fill out paperwork to take out a loan.

In the present article I'll

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sketch the argument. For a fuller treatment, I encourage interested readers to come to Nashville on July 22-23 for the "Night of Clarity." (Full details at http://www.usatrustonline.com/.) In my talk for the Saturday workshop, I'll elaborate on the contents of this article, as well as making other points about the mechanics of whole life policies and why IBC works so well.

Term Versus Whole Life Insurance

Term life insurance is "pure" insurance. The policyholder pays a certain amount of money as a premium, so that if he happens to die during the period in question (say, six months or a year), then and only then will the insurer cut a check to his estate. If the term of the policy runs out and the policyholder is still alive, then he gets nothing from the insurer. It's analogous to buying fire insurance on one's house. If there's no fire, then nothing happens, and the money spent on premiums is totally gone.

In contrast, a whole life policy (as the name suggests) is designed to last for a person's entire life. As long as the person keeps paying premiums, the policy stays in force; there is no predetermined expiration, as is the case with a term policy, which might be designed for (say) a 20-year term.

As the critics of whole life are quick to point out, the premiums needed to keep a whole life policy in force are much higher than those for a term policy with a comparable death benefit. Part of the difference is due to the continuation option described above. In other words, since the insurer is agreeing to a level premium for as long as the policyholder wants to keep a whole life policy in force, the insurer has to set the premium high enough to cover the additional expectation that the policyholder will die while the policy is in force. In contrast, the vast majority of term life policies expire without the person dying.

In fact, things are even bleaker for the insurance company. At a certain point, the owner of a whole life policy gets a huge check from the insurer *even if he is still alive*. Nowadays the cutoff age might be 121 years. For example, a person might sign up for a $1 million death benefit whole life policy when he's 25. So long as that person continues to make his premium payments, he can go on paying the same premium, even as he ages and becomes a much higher risk. Ultimately, if and when the person reaches 121 years, the insurer company sends him a check for at least $1 million. (In practice it may be more, since the person will have purchased more "death benefit" along the way.)

Now we see why whole life policies are so much more expensive than term policies with the same initial death benefit. A useful analogy is to real estate: The policyholder of a term policy is like someone renting an apartment. He pays the rent month after month, and receives shelter in exchange. But after the term of the lease expires, and the landlord raises the rent, the person moves out of the apartment. He has nothing to show for the money he spent over the years, except the memories.

In contrast, someone

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might *buy* an apartment unit with a mortgage from a bank. This person's monthly mortgage payments will be higher than what the renter had to pay each month, assuming they live in comparable apartments. However, with each month's payment, the buyer acquires more and more *equity* in the property. After keeping up with his payments for (say) 30 years, the mortgage is paid off and the person owns the apartment outright.

The analogy with life insurance should be clear. The term policy in effect is just rented insurance. In contrast, the person who starts a whole life policy gains equity in the policy with each successive payment. Specifically, the *cash surrender value* grows over time. This is analogous to a homeowner calculating how much equity he has in his property, i.e. asking how much it's worth minus how much he still owes on it.

For whole life, the cash surrender value is defined as the (present discounted value) of the expected death benefit payout minus the flow of future premium payments. As time passes, the looming death benefit becomes more and more certain, because the person will either die or attain age 121. On the other hand, with each successive premium payment, the remaining number of such payments dwindles, meaning that the policyholder has a freer and freer claim on the death benefit. This is why the cash value of a policy grows over time.

When critics declare that whole life is "obviously" a terrible financial product, because one can get "the same" insurance from a term policy at a much cheaper rate, this is akin to someone saying that buying a house is "obviously" a dumb move because one can rent the same living space for much lower monthly payments. The famous "buy term and invest the difference" strategy ignores other differences too, but in the present article I want to focus on policy loans.

Policy Loans

In order to fulfill its contractual obligations to a whole life policyholder, the insurer must take a portion of each premium payment and invest it conservatively. As a whole life policy ages, the insurer had better have a growing stockpile of financial assets earmarked for the policyholder, so that if and when he reaches age 121, the insurer can hand over the assets now worth (say) $1 million.

From the insurer's perspective, then, there are numerous streams of income every month flowing from the various policyholders. Some of them actually die, and thus payments must be made in accordance with the contractual death benefits. Beyond that, there are salaries and other overhead expenses to be paid. After these expenses, what's left can be plowed into investments so that the total assets of the insurer grow over time, just as the policyholders all think that their cash values are growing.

When a whole life policyholder applies for a loan, the insurer does *not* "take it out" of the policy. Rather, the

Photo from Flickr by: Robert S. Donovan

insurance company takes some of the money that it otherwise would have invested in outside assets, and instead loans it to the policyholder. Strictly speaking, in terms of the cash flow a policy loan doesn't "touch" the whole life policy at all. Rather, the insurer makes a loan on the side to the policyholder.

The insurance company is quite happy to make such a loan, because the policyholder pledges the cash value of his own whole life policy as collateral. To repeat, strictly speaking the policy loan doesn't "suck out" the cash value of a policy, but rather the outstanding loan (depending on its size) offsets some of the cash value. In the same way, if a homeowner applies for a home equity loan, he doesn't literally sell off the guest bedroom to the bank. Rather, he takes out a loan from the bank and pledges the equity in his house as collateral.

A Matter of Liquidity

Now we see why insurers are so free-wheeling when it comes to policy loans, whereas commercial banks and credit unions are much more uptight: the collateral on policy loans is much more *liquid* than on conventional secured loans.

Consider what happens if a whole life policyholder has taken out a $10,000 loan at 5% interest. Suppose he never makes any payments on it, so that the outstanding loan balance has grown to $10,500 a year later. Then the policyholder is hit by a bus and dies.

Does the insurance

company care? Not at all (unless the employees knew the policyholder personally!). Because the man owned a whole life policy, the company now owes his estate a check for the death benefit. Suppose the death benefit originally would have been $500,000. Now, because of the outstanding policy loan, the insurer subtracts the balance and only sends the man's widow a check for $489,500.

In contrast, suppose the man had gone to a commercial bank, asking for a secured loan of $10,000 with his new boat serving as collateral. If the man missed his payment on the loan, the bank would start to worry. As the loan rolled over at interest, it might eventually grow to be more than the underlying collateral was worth. (This isn't likely to happen with a well- structured whole life policy loan, because the underlying cash value grows predictably over time too.)

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Another problem for the commercial bank is that if the man defaults and the bank seizes his boat, the bank might discover that the man didn't take good care of the asset, especially when he saw the default coming. (Again in contrast, there's nothing that the policyholder can do to ruin the cash value in his policy. The insurer doesn't allow him to borrow more against it, than the cash value at any given time. There is no need for the policyholder to do anything "responsible" to keep the collateral in good shape.)

Finally, even if the boat has been kept in good condition, such that its market value is more than the balance on the loan, the bank still has to go through the hassle of *selling* it. This can be a major problem, especially in our current situation where banks are the reluctant owners of millions of foreclosed homes. (Again in contrast, the insurer doesn't have to do anything to "seize" the collateral of the policyholder who defaults on a policy loan. It simply subtracts the relevant amount from the check it otherwise would have sent.)

Conclusion

Once we understand the nature of a whole life policy and how policy loans actually work, it becomes clear why insurers offer loans at such attractive interest rates and almost unbelievable terms. The explanation is that the underlying collateral—the cash value of the policy itself—makes such loans the safest investments imaginable for the insurer. No matter what, they are going to be repaid, because they are already contractually obligated to pay a death benefit to the policyholder. The outstanding loan balance, if any, can just be subtracted before the check is sent out.

Many of the criticisms of whole life policies likewise fall away once we explore the nature of these policies. Carlos Lara, Nelson Nash, Paul Cleveland, and I will explore these ideas more fully in the Saturday workshop at this year's Night of Clarity. (Full details at http://www.usatrustonline.com/.) We will provide an introduction to IBC appropriate for the beginner, but along the way we'll also explain many nuances that even a seasoned agent may never have fully understood. The end result will be to demystify IBC, and show that its amazing results and flexibility don't depend on any gimmicks, but are the result of the nature of the arrangement.

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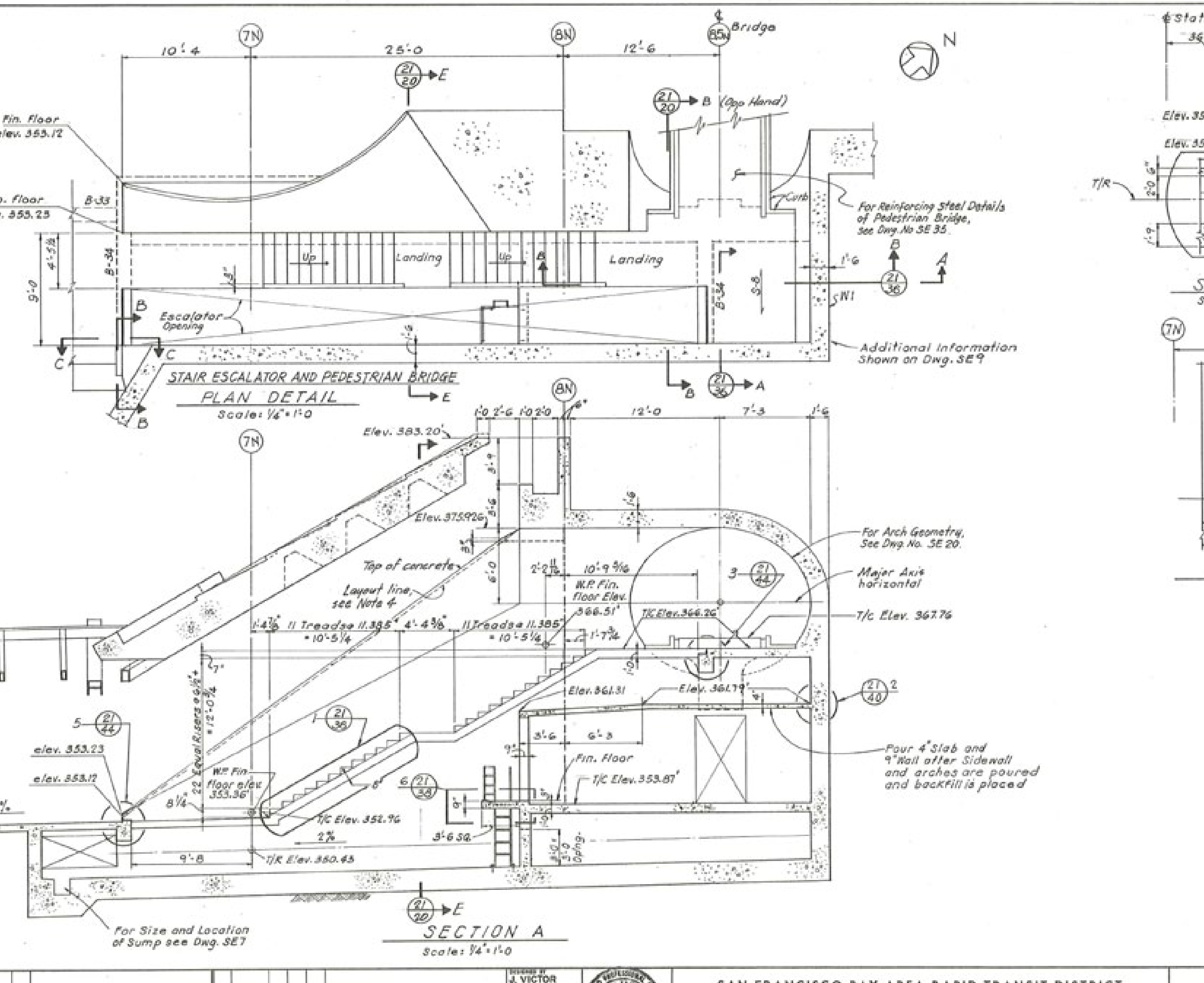

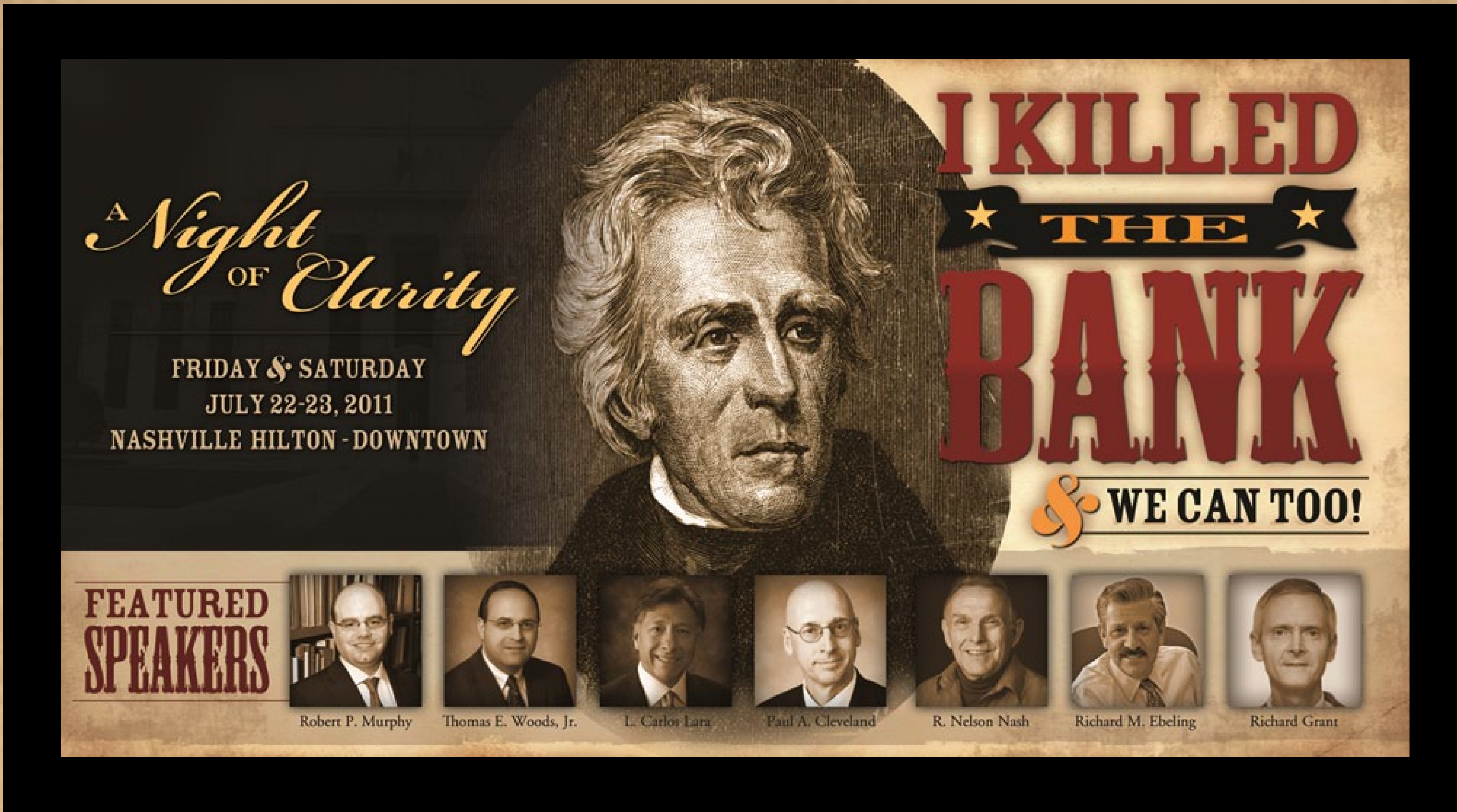

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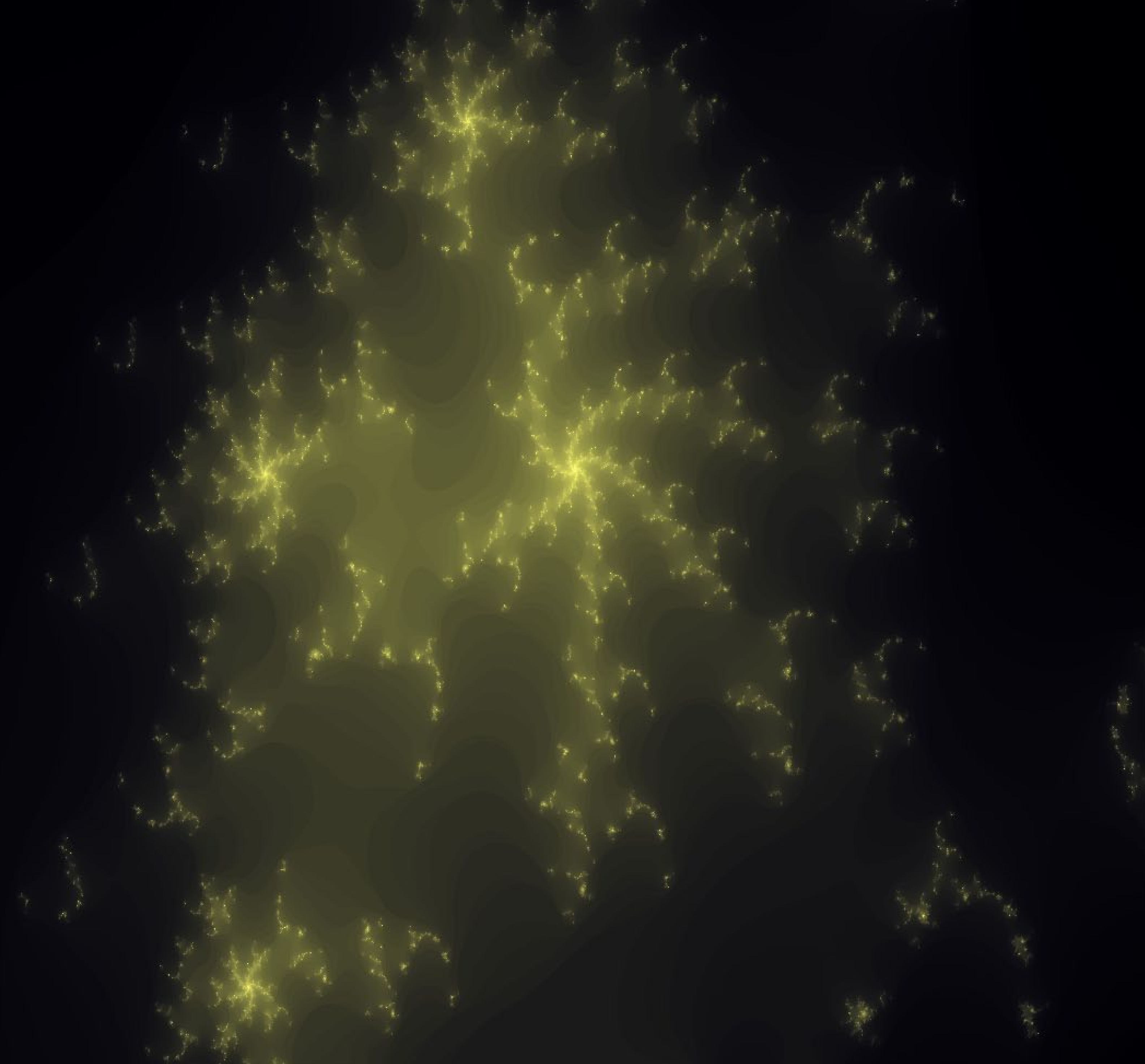

The Heart Of Messynomics

An Interview With
Hayek-Keynes Rapmaster

John Papola

Frame from ***Fight of the Century: Keynes vs. Hayek Round Two*** by EconStories

John Papola is an award-winning producer/director in broadcast entertainment and marketing. Along with Russ Roberts, he created the phenomenal Hayek-Keynes rap videos "Fear the Boom and Bust" and "Fight of the Century," available at http://www.youtube.com/watch?v=d0nERTFo-Sk and http://www.youtube.com/watch?v=GTQnarzmTOc. Papola currently runs a production company at http://www.emergentorder.com.

Lara-Murphy Report: How did you become interested in Austrian economics?

John Papola: I have Ron Paul and Henry Hazlitt to thank for my discovery of the Austrian perspective. In 2007, as the election was ramping up with primary debates, a buddy of mine mentioned that he learned everything he knows about economics from Henry Hazlitt's book *Economics in One Lesson*. With that endorsement, I decided to read the book, which is truly excellent. In it, Hazlitt tackles many subjects but also provides an introduction to the Austrian Business Cycle Theory (ABCT). It just made so much sense and was so clearly a direct extension of "micro" economics vs. the disconnected land of modern "macro" economics. Prices matter for decision-making. Interest rates are a price that impacts investment decisions broadly. Messing with interest rates causes systematic problems with investment decisions. Where's the controversy?

I was already in the process of transitioning from being more conservative by virtue of upbringing and tradition to more of a libertarian driven by ideas and empirical reality when Ron Paul's campaign caught my attention. The crack in the conservative armor for me, actually, was the realization that the so-called "war on drugs" was a horrible, fraudulent mess. It didn't reduce drug use or make the country safer. It wasn't for the good of "the children." Instead, it appeared clearly to be the (literal) "bootleggers and Baptists"[1.] problem at work and a largely racist scheme, which has transformed America into a country with 4% of the globe's

Title Page Art By John Connolly

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total population and 25% of the globe's prison population. That's not the kind of stat I want for my country. Prison state, is not a badge of honor.

So Ron Paul appealed to my increasingly libertarian point of view. When the 2008 financial crisis began to unravel, it became clear to me that only Ron Paul among the guys on stage from either party had anything credible to say. He was the only one to take the signs of crisis seriously and the only one to discuss monetary policy in any form whatsoever. So I read some of his books. I started listening to Bloomberg podcasts and to EconTalk with Russ Roberts. Then I discovered Murray Rothbard and Mises.org and Fee.org and a host of Austrian economics sources. The econ bug bit me and there was no turning back.

LMR: The obvious question: How in the world did you and Russ Roberts (an economist at George Mason University) end up creating a rap video featuring Friedrich Hayek and John Maynard Keynes?!

JP: EconTalk, Russ' podcast, became my favorite source of information and introduction to new ideas and new thinkers.[2.] Russ is peerless in his ability to engage people from a wide range of ideological points of view with dignity and grace yet challenge their positions and even challenge his own. I admired that, and still do.

When the worst of the 2008 panic struck and the world was told that taxpayers needed to bail out the richest people on earth AND stop saving so much because the only solution to a bad debt crisis is to dig even deeper, I decided that I had to take more action than just rabid Facebook posting. I cold-called Russ, feeling that I needed an economist partner and knowing from afar that Russ was both honest and creative, and left a message that I was a TV exec and director who wanted to make videos about Austrian economics and monetary policy. That is indeed a weird message to leave. Luckily, he called back. We began collaborating and over the course of 2009 wrote, produced and ultimately filmed "Fear the

> Right now that original video has 2.3 million views on YouTube.

Boom and Bust."

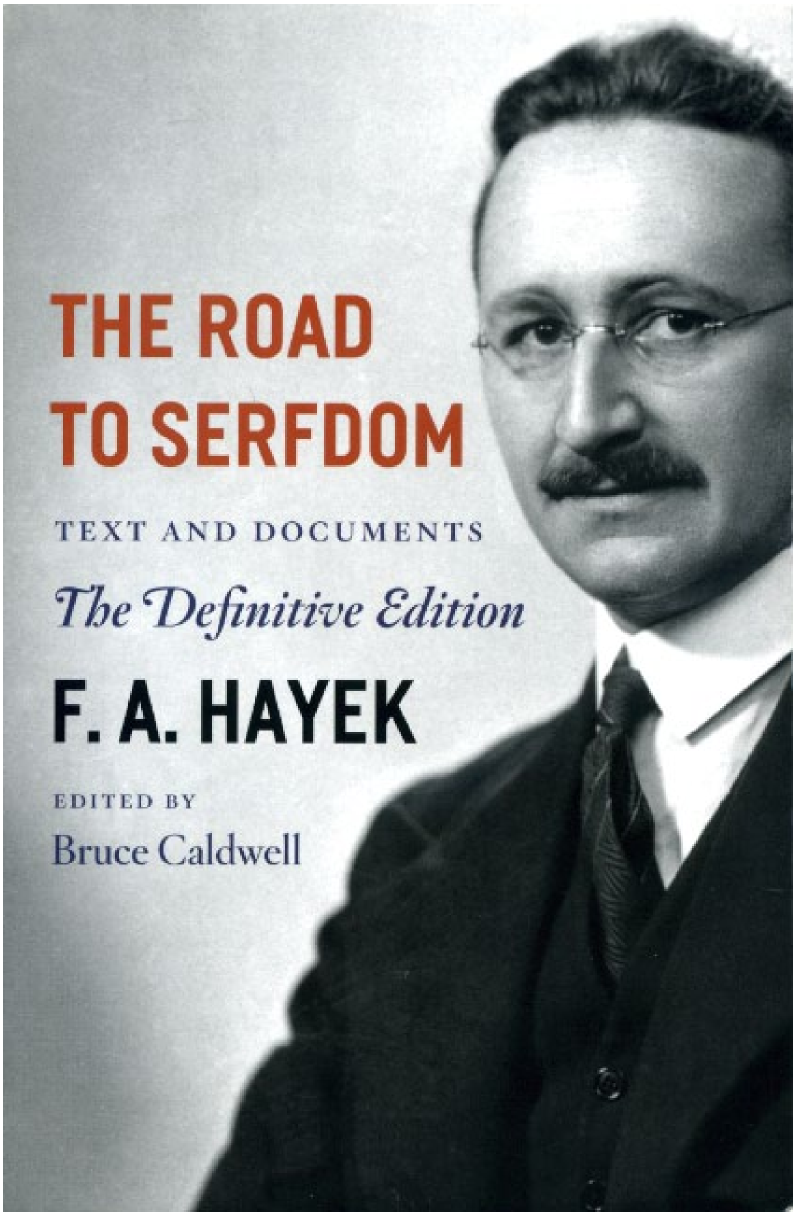
Lisa, my wife and creative collaborator, was the first person to push that we should do music, since "this stuff is boring" as she put it. We looked at the success of Flight of the Conchords as a model. Russ and I batted around a few ideas, none of which felt exactly right, when Russ joked that we should do a rap song. That stuck. Neither of us had written a rap song before, and Russ hadn't listened to much (if any), but it just felt like the right format for a debate of this sort. It was a good choice.

For the sequel, "Fight of the Century," we wanted to up the ante on every front while digging deeper into the political economy of Keynes vs. Hayek using the same basic creative framework. So the song is more ambitious, featuring Rich Murphy singing a melodic refrain, and the visuals are at a dramatically higher level of production. It's by far my best directing effort to date and everyone involved in the production (and there were many people) brought their "A" game to the project. I love them all. This is also the first production executed under our new company, Emergent Order (www.emergentorder.com).

Frame from ***Fear the Boom and Bust*** by EconStories

LMR: For that first video, you guys surely knew that you were producing a high-quality product, but did you have any idea how popular it was going to be? Right now that original video has 2.3 million views on YouTube.

JP: We hoped for that kind of success, of course, but there's just no way of knowing ex ante if what you're doing will connect. What I did feel very confident about was our ability to make something entertaining and high quality. I've spent years doing short-form filmmaking in the creative groups of various networks and feel pretty confident about my ability to deliver, working with my amazing team including Lisa and my partner Josh Meyers. One of my colleagues used to always say, "viral is not a strategy" and he's exactly right. Saying "I want to make a viral video" is like saying "I want to make a box office hit." Of course you do. That's an end, not a means. So our strategy was to approach the music and production seriously. These videos aren't parodies or jokes. We tried to make genuinely good songs with genuine music video visuals. The goal was timelessness and I think we achieved it.

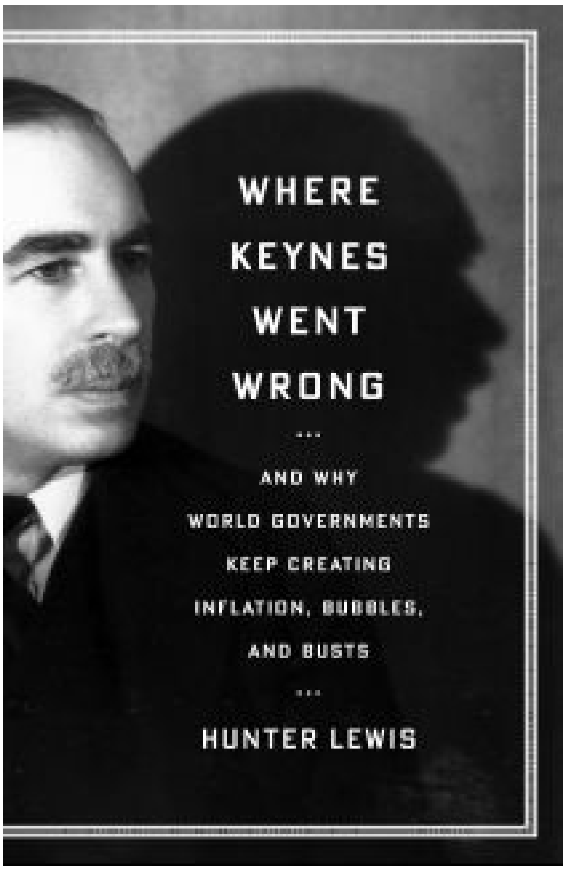


"Fight of the Century" in particular crosses over from being a music video into more of a short film, which I love. I'm a pretty conventional filmmaker in many ways, stylistically. I love classic composition and editing. You won't find many instances of super-stylized/funky visual tricks in my work. I try to focus on the story, the characters and a polished execution.

One element of our success that I think is very important is the fairness with which we treated Keynes and Keynesian theory, especially in "Fear the Boom and Bust." We're confident enough in our ideas to present both sides in a full way and, as a result, our work is more inviting to people from all points of view. The scope of media coverage for our work really speaks to that. Both videos had their press debut on NPR, for example. I'm proud of that. I appreciate the efforts of any honest person trying to make the world a better place. Why alienate people by, for example, comparing your opponent's views to, say, the phlogiston theory of fire?[(3.)] Insulting people only demonstrates that you're a hack and undermines your ideas.

Both videos had their press debut on NPR...

We do hammer the politics of Keynesianism and it's implication harder in "Fight of the Century," which have led some to see it as more "ideological," but I think there's just reason for that. It is a giant blind spot in the Keynesian approach that "G" (government) is assumed to be a wise, technocratic entity that can act exogenously. We're really channeling James Buchanan and "Democracy in Deficit: the political legacy of Lord Keynes" with this one. I think it's a fair criticism. Google "the failure of Keynesian politics" and you will find surprising agreement on these points, even concessions from some Keynesians. Keynes himself conceded that it appeared only war could get a government to spend enough to prove his case. That's not a great situation for a theory of recovery, especially given the fact that we have recovered from recessions without a war or excessive "stimulus" many times.

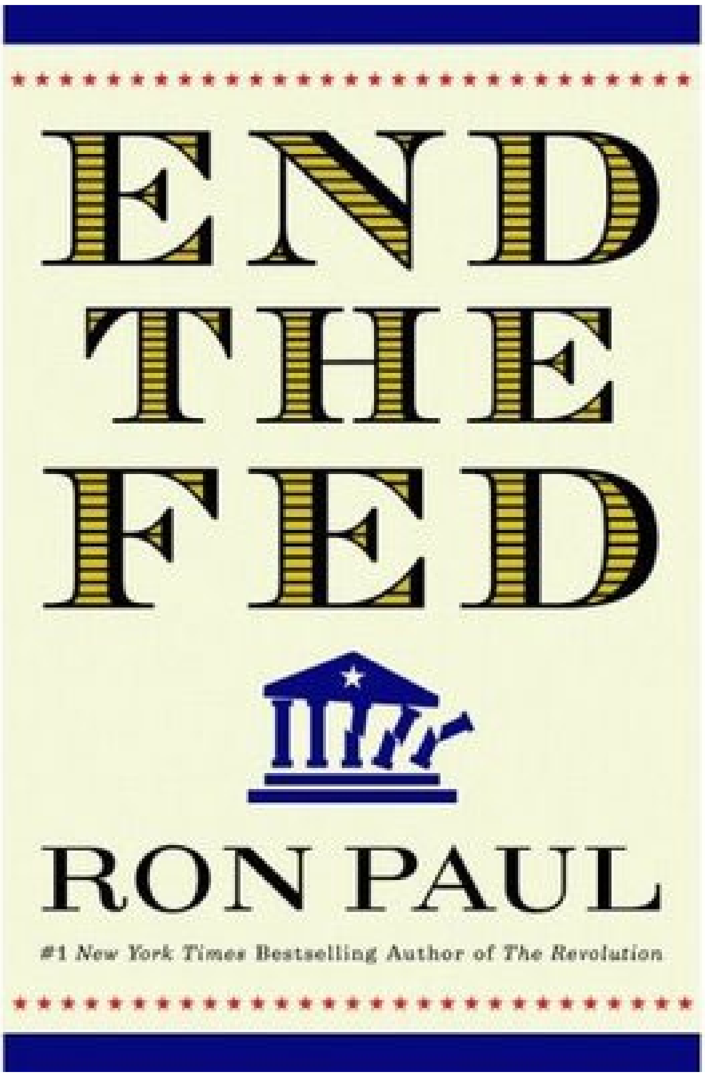


LMR: Judging from your posts on Facebook, it seems that you are becoming a much more radical free-market guy than simply someone who thinks the Fed causes the boom-bust cycle. Is that an accurate observation? As you've become somewhat of a celebrity in Austrian and libertarian circles, are you becoming more immersed in the worldview?

JP: A celebrity?! To the extent that that may be true, it's incredibly weird. Why should anyone listen to me, a TV and film guy with no formal econ training? It is very flattering for you to say that and it's very exciting for me as someone with an evangelical zeal for spreading the ideas of liberty and peace. I hope I can be a positive force for good change.

Truthfully, I am lucky to have come at these ideas from the odd perspective and experience that I did. Lacking formal economics training of any kind can be a blessing when approaching Austrian ideas since some of the methodology is so much different from what is taught in most schools.

As for the more "radical free-market" thinking, I don't believe my opinions are particularly radical in light of the way the founders openly spoke of the government in general. Washington and Jefferson saw government for what it really is: force, violence and coercion. Sure, they went ahead to participate in it, but that's another matter. They believed the state should be constrained to the best of our ability, like a wild beast that needs to be caged lest it go on a rampage and destroy everything around it. It is the "leviathan." That's how they discussed the state. So the forcefulness of the arguments I make against government monopoly power, inspired in no small part by Murray Rothbard, are totally within the bounds of the American tradition of patriotism as I understand it. I am patriotic about our cultural/national ideals of freedom and tolerance. I am not patriotic about government nor do I believe that government is "us" or is the nation itself.



Again, I came to these ideas first through my recognition that the war on drugs is a fascistic assault on the American people (and mostly the African American poor). Yes, it is fascistic. That term is not hyperbole. Just ask Mayor Cheye Calvo, of Berwyn Heights, Maryland, who had a paramilitary DEA SWAT team raid his house and kill his dogs because they thought he was a drug dealer (he's not) and were then congratulated for their fine execution of protocol despite terrorizing the wrong people. Ask the average person if it makes sense for the majority of the incarcerated to be in prison for possession of small amounts of cannabis. It's an insane policy that destroys millions of lives. That's not the America I want to live in.

So yes, my views about freedom extend far beyond economics. But sound economics does provide the best framework for organizing one's thoughts about social issues and avoiding the kinds of fallacies and intellectual traps that lead so many to advocate bad policies despite good intentions.

I am a classical liberal in the tradition of Locke , Mises and Rothbard to be sure. I believe that people have a natural, inalienable right to ownership over their own body and mind. Property rights flow naturally from that core truth. And while this right doesn't ensure its own existence and requires active protection in the real world, it does shape my view of what is and is not ethical and just philosophically. That said, I'm always exploring these ideas and by no means discount the consequentialist arguments for liberty. We need every tool we can muster in the defense of our freedom and society built on true justice.

LMR: Can you give any broad suggestions as to how Austrians and libertarians can better communicate their ideas to the general public? We obviously think we have truth on our side, but it seems the interventionists have done a much better job on a cultural level.

JP: Have some heart, damn it! I think that the energy put into attacking "altruism" by some prominent voices for freedom and free markets has been a net negative for the movement. Every libertarian I know arrives at his or her beliefs out of desire to make the world better for the weakest people among us. We see government power, I think correctly and provably, as a MAGNIFIER of narrow special interests, not a check against them. This is a very powerful point and one that Ron Paul very effectively makes all the time. It's a point that is utterly lost when the argument turns toward ideas of "efficiency." I keep the morality of our ideas at the center of my thinking, as I think Rothbard did. He's very Smithian in that way, though I imagine he'd have some trouble with that comparison.

So heart matters. Empathy matters. Showing that you actually care matters. And of course, caring itself matters. This isn't a marketing pitch, or, I should say, it isn't marketing alone because in a way, it IS about marketing. It's about bringing to

Photo from Flickr by: Warren Pearce

the surface the very powerful, just and persuasive case for freedom that is not just economics in the positive sense, but morality and ethics.

On the flip side, I think everyone could stand to gain from more humility about the limits of our knowledge. Learn Hayek's lesson. I think embedded in good economics is an appreciation for the sheer complexity of the world and the limits of our knowledge and understanding. These are very Hayekian ideas and I think very "Austrian" in a broad sense.

Austrians have an approach that is very uniquely positioned right now. Many progressives are criticizing "rational expectations" and "efficient market hypothesis" and, I think, the general methodology of the Chicago

School. I don't know that these criticisms are all intellectually honest or entirely justified on the grounds with which they are made. But there is a grain of truth in them and it is a grain of truth that they share with the Austrian perspective. It's of course a little strange for people coming from the highly mathematized Keynesian perspective to lay claim to the economics of a messy world. [Paul] Samuelsonian economics ain't messynomics folks. Sorry.

People act with purpose. They envision ends for themselves that they believe subjectively will make them feel better off. They pursue those ends using the best means at their disposal with a mix of logic and emotion and sense of social context. The world is a messy place and I think people naturally judge ideas in part on their moral claims. Austrians, more than any other school of thought, have a rightful claim to "messynomics." I listened to Joe Salerno's podcast series where he called the Austrian methodology a "causal realist approach." That is a great way to discuss it. Similarly Pete Boettke focuses on human action in the real world of institutions. I learn a lot from both of these great thinkers.

And that's probably my last point. As I've gotten to know more people in the community, I've been made aware of various rivalries. I personally have no interest in any of that. It's a point I made in my talk at the Austrian Scholars Conference in 2010. I draw from Rothbard and Friedman and Hayek and Salerno and Boettke and White and Garrison and Murphy and Hazlitt and Say and on and on… The intellectual exploration of these ideas is great. The movement is healthy and made healthier by the internal disagreements and controversies. But let's not forget that most of us are hairs away from one another compared with the other side who see coercion as an acceptable social tool.

John at the Austrian Scholars Conference 2010

The Heart Of Messynomics
Bibliography

1. Editor's note: "Bootleggers and Baptists" refers to a famous economic analysis by Bruce Yandle in which the costly policy of alcohol prohibition was supported by criminal bootleggers and upstanding religious voters.
2. http://www.econtalk.org/
3. As Paul Krugman referred to the Austrian theory of the business cycle. See: http://www.slate.com/id/9593/.

Events & Engagements

2011

JULY 14-16 · LAS VEGAS, NEVADA
Murphy and Lara Present: Privatized Banking Session at "FreedomFest"

JULY 22-23 · NASHVILLE, TENNESSEE
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