Nelson Nash’s live seminars for the next two months (The seminar sponsor or contact person is listed with phone and e-mail address in case you want to attend)

Thursday-Friday, 21-22 August, Austin, TX – Kirk Attwood 512-563-9827, kirk@uniqueconomics.com

Tuesday-Wednesday, 26-27 August, Austin, TX – Tom Eckols 512-656-4981, tom-eckols@glic.com

Tuesday-Wednesday, 9-10 September, Lufkin, TX – Ricky Heard 936-564-1735, ricky@cbhins.com

Friday-Saturday, 12-13 September, Hillsboro, TX – Nancy Jackson 254-582-3565 or 254-582-3037, nancy@bcbstexas.com

Thursday-Friday, 18-19 September, Little Rock, AR - Becky Rice 501-221-7400, becky@rebecccarice.net

Thursday-Friday, 25-26 September, Chicago, IL - Melissa Shary 312-957-9400 x401, mshary@nationalprivate.com

Here is a listing of Nelson’s newly added Book Recommendations

Who Killed the Constitution? The Fate of American Liberty from World War I to George W. Bush by Thomas E. Woods, Jr.

The following articles are Nelson’s favorite finds from the last month’s reading

“Dr. Tom Woods was the featured speaker at the IBC Think Tank Session in Birmingham on July 23.”
- Nelson

Who Killed the Constitution?

by Thomas E. Woods, Jr.

Today [8 July, 2008] is the official release date for Who Killed the Constitution? The Fate of American Liberty from World War I to George W. Bush

Nelson’s Favorite Quotes of the Month

Mere precedent is a dangerous source of authority.
- Andrew Jackson

Things should be made as simple as possible, but not any simpler.
- Albert Einstein

When a man knows he is to be handed in a fortnight, it concentrates his mind wonderfully.
- Samuel Johnson

History is a lie agreed upon.
- Napoleon Bonaparte

Imagination is more important than knowledge.
- Albert Einstein

The point is to develop the childlike desire for recognition and to guide the child over to important fields for society.
- Albert Einstein

People only see what they are prepared to see.
- Ralph Waldo Emerson

Without this playing with fantasy no creative work has ever yet come to birth. The debt we owe to the play of the imagination is incalculable.
- Carl Jung

In a sense, our book states the obvious: the United States government today is restrained not by the Constitution but simply by a sense of what it can get away with.

But ours is not the standard right-wing lament about the emasculation of the Constitution at the hands of liberal judges, though such judges receive in our pages none of the superstitious reverence Americans are taught to have for the judiciary. (Mencken once described a judge as merely a law student who graded his own examination papers.) To the contrary, we suggest that all three branches of the federal government, either separately or in collusion, have been responsible for turning the Constitution into just a museum piece, and that conservatives and liberals alike have much to answer for as well.

To hear the Left tell it, the Bush administration is a strange aberration in our history. But bad as the Bush administration is, it not an aberration, and most of its deformations of the Constitution enjoy bipartisan support. The Democrats have made and will doubtless continue to make equally bold claims for presidential war powers, and Bill Clinton sought measures similar to the Patriot Act in the 1990s.

As I wrote in last year’s 33 Questions About American History You’re Not Supposed to Ask, "The philosophy of an activist, vigorous executive possessing inherent powers that override congressional prerogative is not a recent development at all, but has been an integral part of the thinking of most of the presidents our historians teach us to admire. Demonizing only one president, as the left is by and large still doing in 2008, is far too timid. So many others merit the same treatment."

We show that Harry Truman’s seizure of the steel mills in 1952, for which the Supreme Court rebuked him (though not as sweepingly as the standard account suggests), was based on the same philosophy of the presidency that nearly all twentieth-century presidents held, and was likewise no aberration at all.

Woodrow Wilson is another good example, for more reasons than we can chronicle in this book. As Bill Kauffman puts it, Wilson makes George W. Bush look like a pro bono lawyer for the ACLU. In tandem with draconian penalties for the most harmless statements about the Great War, voluntary enforcement agencies with names like the Sedition Slammers, the Terrible Threateners, and the Boy Spies of America sprang up across the country. Eugene V. Debs made the best of his situation, collecting a million votes for president in the 1920 election while in prison for giving a speech. (A popular campaign button read, "For President: Convict No. 9653.") All three branches of government heartily approved.

Now people who draw the conclusions that our book does in the cases relating to race can be assured of smears and character assassination. The intentions of anyone advancing them are assumed to be bad, so their reasoning is ignored. That’s how our society works, and media and education establishments populated by cowards and ignoramuses keep it that way. Likewise, writers critical of President Bush and the constitutional theories of those under him will be accused of "aiding the terrorists." Rational discussion of what the Constitution actually says, regardless of whom it offends, almost never occurs in such an environment. Every significant appeal to the Constitution, supposedly the fundamental law of the land, is a thought crime of one kind or another. That seems to be just the way the political and media establishments like it.

We also cover the issue of presidential signing statements, by which President Bush has pledged to interpret various laws in ways that are at odds with congressional intent, or not to enforce them at all. Such statements often go overlooked, buried in collections of official documents. But Bush has used the signing statement to challenge twice as many legislative provisions as all previous presidents combined. (And no, he’s not challenging them because they’re unconstitutional and he’s such a constitutional stickler.)
We show the alleged constitutional power to draft people into the armed forces to be without foundation; one of the arguments the Court used to uphold it was that all the cool countries were doing it – Russian, Austrian, German, Japanese, and Chinese emperors drafted their citizens, after all. Surely the U.S. can't be "one of them loser countries," to borrow a phrase from Moe Szyslak.

We likewise cover forced busing, medical marijuana (the federal government’s arguments against it have to be read to be believed), the confiscation of Americans’ gold in 1933, and the federal government’s dishonest treatment of church-state relations. We even tread upon the third rail of American jurisprudence: Brown v. Board of Education. And lots more.

It’s interesting and revealing to consider the two figures whose blurbs we feature on the back cover. One is Judge Andrew Napolitano, an avid reader of this site who is also senior judicial analyst for Fox News. The other is Kirkpatrick Sale, who is resolutely a man of the Left but who still favors the kinds of values the Left once believed in, including Jeffersonian decentralism and a distrust of bureaucratic solutions to human problems. Both men are equally aghast at what our one-party system has done to the Constitution, and to American freedom along with it.

Publishers Weekly almost seems to like the book, which briefly made us think there might be something wrong with it, but we finally decided just to accept its respectful review gracefully.

Lysander Spooner once said that he believed "that by false interpretations, and naked usurpations, the government has been made in practice a very widely, and almost wholly, different thing from what the Constitution itself purports to authorize." At the same time, he could not exonerate the Constitution, for it "has either authorized such a government as we have had, or has been powerless to prevent it. In either case, it is unfit to exist."

Harsh words, yes. But there is a contradiction at the heart of the very idea of constitutional government, that makes a constitution’s perversion all but inevitable. How can an institution be restrained by a document that it has a monopoly on interpreting? The problem becomes all the worse when that institution also (practically speaking) monopolizes the education of children, who are taught that "flexible" interpretation of the Constitution by their betters is perfectly normal and just what the American people signed on for.

That, in a nutshell, is what Who Killed the Constitution? is all about. A better question, in light of all this, might involve who killed the Articles of Confederation.

July 8, 2008

Thomas E. Woods, Jr. [view his website; send him mail] is senior fellow in American history at the Ludwig von Mises Institute and the author, most recently, of Sacred Then and Sacred Now: The Return of the Old Latin Mass and 33 Questions About American History You’re Not Supposed to Ask. His other books include How the Catholic Church Built Western Civilization (get a free chapter here), The Church and the Market: A Catholic Defense of the Free Economy (first-place winner in the 2006 Templeton Enterprise Awards), and the New York Times bestseller The Politically Incorrect Guide to American History.

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Time To Celebrate Business

by Llewellyn H. Rockwell, Jr.

I admit to liking one aspect of our recessionary environment. It focuses the mind on what really matters, so that we are just a bit less likely to take wealth for granted. This is a tendency of everyone who lives in a booming economy. We tend to think of the wealth that surrounds us as a fixed part of nature, something that is not going away and can therefore be toyed with and manipulated by state actors.
People indulge in every sort of political fantasy about redistributionism during good times, but these fantasies evaporate once it becomes clear to us that wealth can vanish far more quickly than it came. Employees are laid off out of necessity, and then the businesses themselves start to fail. People's lives are disrupted, and economics suddenly takes on a new importance. We begin to see just how important it is to get the goods and services we need, that our jobs are secure, that we can make our dreams reality.

The tradeoffs associated with enterprise become ever more obvious in recession. A slight uptick in the price of raw materials can cause an enterprise to take a fall. New legislation that increases the cost of labor can yield unemployment. Programs such as Social Security that tax the heck out of business and labor are more easily seen as drains on productivity than social benefits. And when our stocks tumble, we are slightly more likely to cheer on producers than to imagine ways that we can slice and dice them.

If we really understand the message of an economic downturn, we would all become pro-producer and anti-government, for it is government that is to blame for interrupting the progress of free enterprise. It does this by increasing the costs of wealth production, and by tricking producers through the manipulation of interest rates, generating the boom which is followed by the bust. What's more, government's existing costs of doing business inhibit recovery. Imagine if we lived in a pure market economy without taxes and regulations of any sort. Anyone could start a business and keep their earnings. That recovery would happen quickly is without question.

But today government adds enormous costs to doing business successfully. Hiring is inhibited by wage laws, mandated benefits, anti-discrimination laws, payroll taxes, and fantastic costs associated with accounting and compliance. It differs according to the business, but all such costs are far higher than they ought to be. One reason that the recession of 1921 went away is precisely because we weren't yet saddled with a central planning apparatus and prices and wages were given the freedom to adjust. These days matters are much more complex and costly, which is one reason we all fear that recovery will not be quick.

Listening to the presidential candidates, we have no inkling that it will be private producers and only private producers that will lift us out of the economic doldrums. To hear their speeches, you would think that government is capable to pushing the right buttons to restart the economy. But here is the fact: government has never done anything to bring about recovery and it never will. The best course for the political establishment is to recognize that recessions represent their own failure and then conclude that getting the state out of the way is the best course of action.

The process of wealth creation is far too complicated and difficult for the political class to understand. Consider just one sector: the wine industry, which Forbes has covered in detail in its latest issue. People imagine that the wine business involves luxuriating in a beautiful home in an idyllic environment, sipping vintages on a big porch, and basking in the status that comes from being an owner of land.

In fact, it is grueling and risky business that can cost tens of millions of dollars and take upwards of seven years before a single dime of revenue comes your way. There are the inherent costs associated with buying land, planting, vines that must be tended, waiting, and harvesting. There are tasting rooms to build. Then there is the problem of marketing since wine doesn't just sell itself. The competition is grueling and what appears to be a breakthrough doesn’t necessarily last.

On top of an already expensive process is added the regulatory environment. As Forbes says, "Producing and selling an alcoholic beverage in America is a complicated endeavor wrapped in layers of tangled red tape. There are licenses and permissions to be acquired from the Alcohol and Tobacco Tax and Trade Bureau (TTB), and even a long, complex process through which the label for the bottle must be approved by the TTB. That's all before you have to start tracking sales and computing and paying excise taxes."

Have a look at the Frequently Asked Questions at the
website of the Tax and Trade Bureau of the U.S. Treasury. There's no romance in this:

What are the Federal requirements for "Custom Crush" clients and winemakers?

The custom crush client may be required to obtain a Federal Wholesaler’s Basic Permit from TTB. This permit allows the client to engage in the business of purchasing wine for resale at wholesale, in accordance with the Federal Alcohol Administration Act at 27 U.S.C. 203(c)(1) and 27 CFR 1.22. Although the client is specifically paying for the producer’s services, the client has purchased wine (within the broad meaning of the term) at the price set in the agreement. If the client engages in activities normally associated with wholesaling, such as setting the price for the wine, determining which dealers will be sold the wine, and controlling and paying for advertising of the product, the client must have a wholesaler’s basic permit. If, however, the client merely receives the proceeds from the sale by the winery of the resulting wine, a permit would not be required. In addition to the basic permit requirement, the custom crush client who engages in the business of selling wine is liable for Special Occupational Tax as a wholesaler ($500/year) if the wine is offered for sale to other dealers, or as a retailer ($250/year) if the wine is only offered for sale to consumers.

Given all the regulations, it is a wonder anyone does any business at all. And to think that the wine business is not exactly new. It dates to the ancient world, and survived and thrived for many centuries without a Tax and Trade Bureau. These people are not necessary for the world of wine, and their only contribution to wine production is to harm producers and raise the price for consumers. So it is in every sector of economic life.

Recessions are a great time to appreciate anew the importance of economic logic to our lives, to celebrate the contribution of market production, and to seriously reevaluate the merit of big government that we permit to thwart the prospects for a speedy economic recovery.

Llewellyn H. Rockwell, Jr. [send him mail] is founder and president of the Ludwig von Mises Institute in Auburn, Alabama, editor of LewRockwell.com, and author of Speaking of Liberty.

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Fannie, Freddie, Fascist

by Llewellyn H. Rockwell, Jr.

Ludwig von Mises had a theory about interventionism. It doesn't accomplish its stated ends. Instead it distorts the market. That distortion cries out for a fix. The fix can consist in pulling back and freeing the market or taking further steps toward intervention. The State nearly always chooses the latter course, unless forced to do otherwise. The result is more distortion, leading eventually, by small steps, toward ever more nationalization and its attendant stagnation and bankruptcy.

When you think about the current Fannie Mae-Freddie Mac crisis, you must remember Mises's theory of intervention. Reporters will not, but you must, provided you want to understand what is going on. President Bush is considering a fateful step in a 60-year-old problem: the nationalization of these mortgage companies. He wants to guarantee the $5 trillion (that's trillion with a "t") in debt owned by these companies. Another option would be to put these monstrosities under "conservatorship," which means that you and I will pay for their losses directly.

Either way, it turns out that there is no magic way to put every American citizen, regardless of financial means or credit history, in a 3,000 square foot home. Someone, somewhere, sometime has to pay. No matter what rescue plan they are able to cobble together, that someone is you.

The heck of it is that any option would be devastating to the already-suffering housing market. The reason this sector was so wildly inflated is that banks knew
that Fannie and Freddie were capable of buying any mortgage debt created by the banking industry. For these companies to be nationalized would effectively end their capacity to do this on a market basis. That means banks would suddenly have to act responsibly.

Now, you might say, if that's true, the real blame is with the individual bankers that had been making irresponsible loans under the condition that these government-sponsored enterprises would absorb them. But that's not right. Put yourself in the shoes of a banker over the last twenty years. You have competitors. You have a bottom line. If you don't extend these loans, you come off as a fool. Your competition eats your breakfast. To stay ahead of market trends means that you have to play the game, even though you know it is rigged.

Place the blame not only on the banks, but also on the institutions that are siphoning off their liabilities for irresponsible behavior, and that would be Freddie and Fannie. And who created these? Travel back in time to the New Deal. Here is an article about the creation of Freddie Mac. And here is another about Fannie Mae.

They were created by FDR in 1938 to fund mortgages insured by the Federal Home Administration. They were used by every president as a means to achieve this weird American value that every last person must own a home, no matter what. So they were given the legal permission to purchase private mortgages and make them part of their portfolios. Still later, under LBJ and Nixon, they became public companies and sold stock. People called this privatization, but that isn't quite right. They had access to a guaranteed line of credit creation with the U.S. Treasury. They had lower borrowing costs than any private-sector equivalent.

Government-sponsored enterprises are not subject to market discipline like regular private sector companies. Their securities are listed as government securities, so their risk premiums were not dictated by the free market. They could leverage themselves at 50-, 75-, 100-1, pyramiding debt on a tiny foundation of equity. The financial markets have long believed that the GSEs would be bailed out no matter what.

And so this put them in a completely different position from a company like Enron, which the markets watched closely. What's causing the current panic is that the markets have wised up and started evaluating these institutions by market standards. Freddie and Fannie have collapsing market prices, and their bonds are carrying ever-higher risk premiums.

In other words, we are not talking about market failure. If you have a housetop you can shout that from, please do so, because the press and the government are going to make every effort to blame private borrowers and lenders for this calamity. But the origin of both these outfits is with federal legislation. They are not market entities. They have long been guaranteed by you and me. No, they have not been socialist entities either because they are privately owned. They occupy a third status for which there is a name: fascism. Really, that's what we are talking about: the inexorable tendency of financial fascism to mutate into full-scale financial socialism and therefore bankruptcy.

Mr. Bush might have prevented this meltdown by curbing the privileges of Freddie and Fannie long ago. But no, he had another plan, one which was assisted by the Republican think tanks in Washington (the curious can Google it up). The idea was a new slogan called the "ownership society."

Sounds nice, doesn't it? Sounds like free enterprise. But if you think about it, there is nothing particularly free market about the demand that everyone should own anything in particular. The idea of free markets is that your rights to own justly are not to be infringed by public or private criminals. The suggestion that everyone should own some particular thing, by whatever means, can only be funded through financial socialism or mass theft. The claim on the part of a government that it will create an "ownership society" can prove to be highly dangerous.

As for the future, Mises's theory that the government will always favor more government seems wholly sound. Here is John McCain: "Those institutions, Fannie and Freddie, have been responsible for millions of Americans to be able to own their own
homes, and they will not fail, we will not allow them to fail…we will do what’s necessary to make sure that they continue that function." Not a single Democrat disagrees.

As with the S&L fiasco from years ago, the case of the housing bust followed by the trillions in taxpayer liabilities for the disaster will again be cited as a case of "the shock doctrine" and "disaster capitalism" in which the elites make fantastic amounts of money at the expense of the little guy. The critique will be mostly solid but for the one most important point: this kind of fiasco would not happen in a free market. It happens because government, through credit creation and guarantees, makes it possible.

Look down the road a bit here. What happens when banks won't lend for houses anymore? What will government do then? We might as well prepare for a future in which applying for a housing loan will have similar features to getting an SBA loan. This is where we are headed.

Government intervention is like a vial of mutating poison in the water supply. We can get by for a long time and no one seems really worse off. One day we wake up and everyone is desperately ill, and blaming not the poison but the water itself. So it is with the housing crisis. Lenders are being blamed for the entire fiasco, and capitalism is going to be subjected to a beating as usual, since Freddie and Fannie are traded in public markets. But the fact remains that there is only one reason that this went on as long as it did and became as bad as it is. It was that vial of government poison.

July 12, 2008

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Fannie and Freddie: playing with a stacked deck

By Bill Bonner

Much of what goes on in public finance is fraudulent. The rest is nonsense. The hardest part of our métier is just figuring out which is which.

As recently as February of this year, Russian officials cleared the way for two of its sovereign wealth funds, the Reserve Fund and National Wellbeing Fund, to invest in various foreign bonds – including those issued by the twin towers of American residential finance – Fannie and Freddie.

“The prospect for every GSE bond clearly states that it is not backed by the United States government,“ says Matt Kibbe, president of FreedomWorks. “That’s why investors holding agency bonds already receive a significant risk premium over Treasuries.”

The Russians ignored the warnings and grabbed the risk premium. Today, fully 21% of Russia’s monetary reserves are invested in the obligations of Fannie, Freddie and the Home Loan Banks. And the largest holder of Fannie and Freddie debt is another friendly foreigner, China. The middle kingdom, according to the FreedomWorks organization, owns $376 billion worth of US agency bonds. Altogether, foreigners hold $1.3 trillion of them.

Maybe the foreigners didn’t understand what they were getting into. Or maybe they did.

Franklin Delano Roosevelt, whose family had made a fortune in the opium trade, promised the nation a “New Deal” during the Great Depression of the ‘30s. But what he gave it was more like the old false shuffle. The president pulled cards from the bottom of the deck, pretending that government bureaucrats could do a better job of allocating capital than private investors. In 1938, he set up the Federal National Mortgage Association, b.k.a. Fannie Mae. Then, as now, the national housing market was in crisis. House prices had been declining for almost a decade. Who wanted to lend money against falling collateral
values? Only a fool...or a government.

For the next 32 years, the firm resembled a nationwide savings and loan institution -- borrowing from large institutions and lending to smaller ones, keeping a piece of the spread for its trouble. But Fannie Mae was an imposter from the get-go. Lenders knew that it had something no free market business ever had – the full faith and credit of the US government behind it. Fannie was able to borrow at below-market rates; lenders knew they had no risk of losing their money in a default or bankruptcy. Fannie, with the aces dealt her by the Roosevelt administration, dominated the business for the next 30 years.

Then, another crisis came along, followed by another bamboozle, this one perpetrated by Lyndon Johnson. Specifically, the feds were spending too much on wars – the War on Poverty at home...and one against the Viet Cong across the ocean. Victory eluded Lyndon Johnson on both fronts, but his handling of Fannie Mae should have brought him at least a bronze star. Attempting to balance the government’s ledgers (this was in the days when Americans still believed in balanced budgets), he moved the mortgage business off of the Federal government’s books, privatizing it as a ‘government sponsored agency.’ For good measure, he created a competing organization – the Federal Home Mortgage Association, a.k.a. Freddie Mac.

Many are the ham-fisted dictators and sticky-fingered kleptocrats who have nationalized industries. Even without a credit crunch for camouflage, Francois Mitterand nationalized 36 leading French banks in 1982. Robert Mugabe grabbed farmland in the Zimbabwe. Evo Morales took the gas industry. And Hugo Chavez seized the Orinoco oil fields in 2007. But Lyndon Johnson rarely gets credit for his great advance in the history of public larceny: he privatized the profits while nationalizing the losses. This formula has been a honey pot for clever dirigistes ever since, providing countless opportunities for defeated politicians, hacks and hustlers – speaking fees, consulting contracts, board memberships, bonuses, stock options (notably, the $170 million spent on lobbyists over the past 10 years...mentioned above) -- things that wouldn’t be possible for a “public” company. In effect, Fannie Mae could pick the taxpayer’s pocket twice – once by sticking him with a mortgage he couldn’t really afford and a second time by raiding the taxpayers’ vault for a bailout.

In the case at hand, by the year 2007, the CEOs of Fannie and Freddie were earning salaries that would have been respectable, even on Wall Street. Fannie’s main man, Daniel Mudd took home $13.4 million in 2007, a year in which the firm lost $2.1 billion. While the Freddie Kruger of mortgage finance, Dick Syron, pocketed $18.3 for helping Freddie Mac to a $3 billion loss and a 33% trim for the shareholders.

As recently as May of this year, Mr. Mudd told the New York Times that he was “seeing the best opportunities since I’ve been in this business.” Two months later, both Fannie and Freddie are “insolvent,” says former Fed governor William Poole.

In a better world, Mudd and Syron would be hanged...and the bondholders would be wiped out along with the shareholders. But last Sunday, US Treasury Secretary Henry Paulson announced a bailout. And on Monday, an auction of Freddie Mac debt was oversubscribed. The Russians were right; the deck was stacked from the very beginning.

Stock Buybacks Are a Scam

by Eric Englund

When a talking head, on CNBC, proclaims that Company X has announced a stock buyback, it is unfailingly hailed as good news for shareholders. After all, in the world of high finance, cash is trash, leverage is good, and stock buybacks can boost earnings per share and the price of the stock itself. When stock buybacks are executed judiciously, shares are purchased when management recognizes that the stock is undervalued – as it is preferable to buy while the price is low (at least that’s the theory). All of this is done, of course, under the guise of enhancing shareholder value. Hence, what is good for the
shareholder (i.e., a stock buyback) must be good for the company itself. This is exactly what the charlatans, of Wall Street, want you to believe; and it is a lie.

The financial distress, besieging America’s largest financial institutions, exposes the pernicious nature of stock buybacks. Call me old fashioned and financially conservative as I have never agreed with the idea that weakening a company’s balance sheet is beneficial for the company and its shareholders – yet, it does benefit a very select group of shareholders and this will be covered below. Repurchasing shares weakens a company’s balance sheet in three key ways in that cash, working capital, and equity are diminished by the dollar amount of the shares repurchased. When a company’s stock-buyback program, over time, adds up to billions of dollars, the negative financial impact can be staggering.

The stock prices, of America’s largest banks and brokerages, have been getting hammered. Yet the declining stock prices fly in the face of the "wisdom" of buying back shares in that a scarcer number of shares should lead to higher stock prices. The following table, comprised of seven high-profile American financial institutions, neatly exposes the falsehood that stock buybacks increase shareholder value.

<table>
<thead>
<tr>
<th>Company</th>
<th>5-Year High</th>
<th>Present Price</th>
<th>From 2001 Through 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Citigroup</td>
<td>$55.70</td>
<td>$19.35</td>
<td>$32.2 billion</td>
</tr>
<tr>
<td>J.P. Morgan</td>
<td>$52.54</td>
<td>$40.02</td>
<td>$17.1 billion</td>
</tr>
<tr>
<td>Lehman Brothers</td>
<td>$85.80</td>
<td>$19.11</td>
<td>$14.7 billion</td>
</tr>
<tr>
<td>Merrill Lynch</td>
<td>$95.87</td>
<td>$30.91</td>
<td>$21.0 billion</td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>$73.45</td>
<td>$38.57</td>
<td>$14.9 billion</td>
</tr>
<tr>
<td>Wachovia Corporation</td>
<td>$59.85</td>
<td>$12.97</td>
<td>$15.0 billion</td>
</tr>
<tr>
<td>Washington Mutual</td>
<td>$46.35</td>
<td>$5.92</td>
<td>$12.4 billion</td>
</tr>
</tbody>
</table>

From fiscal-year 2001 through fiscal year-end 2007, these seven companies have repurchased $127.3 billion of their common stock.

I would argue that each company’s stock-buyback program actually intensified the downward pressure on the price of their respective common shares.

It is well known that there is a global credit crisis and that investors are nervous about which financial institutions will or will not survive through these uncertain times. Top-notch financial strength, consequently, is viewed as a virtue. Thus, it stands to reason that had each of the above-mentioned companies not engaged in such reckless stock buybacks, each company would possess a dramatically stronger balance sheet. In turn, better financial strength provides a company with a greater chance of surviving difficult economic circumstances and, accordingly, would be reflected favorably in the price of its common shares. Return, to any one of these companies, the money it squandered on stock buybacks and you’d see a company with a higher stock price than currently bestowed by the marketplace.

Let’s test, a little more, Wall Street’s "logic" with respect to share repurchases. If a stock buyback is good for a company, shouldn’t buybacks take place when times are tough? After all, during tough times, shouldn’t management do good things for a company? Moreover, if stock prices have dropped
precipitously, shouldn’t management be repurchasing shares hand-over-fist? The actions, of the seven aforementioned companies, speak volumes about such questions; and exposes stock buybacks as nothing more than a Wall Street scam.

Through the first five months of 2007, these seven financial institutions bought back $14.4 billion of their common stock. Through the first five months of 2008, the same exact companies repurchased only $786 million of their shares – a reduction of nearly 95%. It is painfully clear that each company’s management team has determined now is not the time to further weaken their respective balance sheets. Corporate survival may be at stake. After all, share repurchases would further erode the balance sheet and the share price may suffer even further. So, when is it ever a good time to weaken a company’s balance sheet?

In Berkshire Hathaway’s 2005 annual report, Warren Buffett criticized executive compensation schemes in his letter to shareholders. In the following example, Mr. Buffett makes it quite clear that a company’s top executives and managers can be compensated handsomely even if the company’s performance is mediocre or poor. At the epicenter, of such a compensation scheme, is management’s control over whether or not to engage in stock repurchases. Read it and weep:

Too often, executive compensation in the U.S. is ridiculously out of line with performance. That won’t change, moreover, because the deck is stacked against investors when it comes to the CEO’s pay. The upshot is that a mediocre-or-worse CEO – aided by his handpicked VP of human relations and a consultant from the ever-accommodating firm of Ratchet, Ratchet and Bingo – all too often receives gobs of money from an ill-designed compensation arrangement.

Take, for instance, ten year, fixed-price options (and who wouldn’t?). If Fred Futile, CEO of Stagnant, Inc., receives a bundle of these – let’s say enough to give him an option on 1% of the company – his self-interest is clear: He should skip dividends entirely and instead use all of the company’s earnings to repurchase stock.

Let’s assume that under Fred’s leadership Stagnant lives up to its name. In each of the ten years after the option grant, it earns $1 billion on $10 billion of net worth, which initially comes to $10 per share on the 100 million shares then outstanding. Fred eschews dividends and regularly uses all earnings to repurchase shares. If the stock constantly sells at ten times earnings per share, it will have appreciated 158% by the end of the option period. That’s because repurchases would reduce the number of shares to 38.7 million by that time, and earnings per share would thereby increase to $25.80. Simply by withholding earnings from owners, Fred gets very rich, making a cool $158 million, despite the business itself improving not at all. Astonishingly, Fred could have made more than $100 million if Stagnant’s earnings had declined by 20% during the ten-year period.

Indeed, stock repurchases benefit a narrow group of corporate insiders. Not only can such insiders benefit while the company remains stagnant, they can financially benefit while simultaneously demolishing the company’s balance sheet. A perfect example can be found at Citigroup.

As you saw above, Citigroup was the most aggressive company when it came to repurchasing shares. Over the past three quarters, Citigroup has suffered a cumulative net loss of $17.4 billion. To be sure, these losses were "baked in the cake" ten to fourteen quarters ago when Citigroup was speculating in mortgage-backed securities, extending shaky loans, entering into risky transactions with the monoline insurers, and participating in speculative leveraged buyouts. Credit standards were set irresponsibly low so that revenues and net earnings would go sky high. And, in order to goose Citigroup’s stock price and executive compensation, Citigroup engaged in nothing short of an orgiastic stock buyback program. It worked for a while with the stock peaking at nearly $56 per share in December of 2007. Now, the chickens have come home to roost as Citigroup’s share price has collapsed by approximately 65%.

Since Vikram Pandit became Citigroup’s CEO eight
months ago, he has been instrumental in raising $40 billion in new capital for Citigroup. As stated in this July 15, 2008 International Herald Tribune article, Mr. Pandit "...is trying to turn around Citigroup as the banking industry struggles through one of its most challenging periods since the Depression. His task is particularly difficult because many Citigroup bankers, paid with stock and options for years, have seen their fortunes vanish. Morale is low." I have no sympathy for these demoralized Citigroup executives and managers as their "fortunes" were built upon a financially destructive stock-buyback program pyramided upon intellectually bankrupt business and credit practices.

The next time you hear a CNBC talking head gush over a company’s stock-buyback announcement, think of Fred Futile and his self-dealing management style. To praise the weakening of a company’s financial condition reveals the vapid nature of financial reporting. More importantly, the incredible amount of stock repurchased by the seven above-mentioned financial institutions exposes the intellectual and moral rot of countless business managers and their Wall Street enablers. Not a single analyst has cried "foul" and questioned the grotesque balance sheet mismanagement of any of these financial powerhouses (or, more accurately, former powerhouses). To me, this further reinforces my core belief that Wall Street exists to redistribute wealth from the poor and the middle-class to the wealthy. To deny this is to remain comfortable dealing with liars and thieves.

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