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The Ledger

Dollar's Doom?
China's official press agency in October called for ending the U.S. dollar as the world's reserve currency. In an English-language editorial, the Xinhua news agency said the world should consider a new reserve currency "that is to be created to replace the dominant U.S. dollar, so that the international community could permanently stay away from the spillover of the intensifying domestic political turmoil in the United States." **Page 5**

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Benefits of JOBS Act Relief
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Harmful Transactions Taxes
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Resilient Futures Markets
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FIRE Policy News

FINANCE, INSURANCE, AND REAL ESTATE POLICY NEWS

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No Crime Committed, But Feds Seize Bank Account

By John Kramer

Can the government use civil forfeiture to take your money when you have done nothing wrong—and then pocket the proceeds?

That is the question to be answered by a major federal lawsuit that has been filed by Terry and Sandy Dehko—owners of Schott's Market, a family grocery store in Fraser, Michigan—and the Institute for Justice.

In January 2013 the Dehkos were astonished to discover the federal government had seized their entire checking account without warning, even though the Dehkos had done nothing wrong.

"Federal forfeiture law allows the government to take your entire bank account just because it doesn't like the way you deposit or withdraw your money," said IJ Senior Attorney Clark Neily. "The government should not be allowed to just show up at your doorstep like a playground bully and take away

SEIZURE, p. 3

> **"Federal forfeiture law allows the government to take your entire bank account just because it doesn't like the way you deposit or withdraw your money."**
>
> CLARK NEILY
> SENIOR ATTORNEY
> INSTITUTE FOR JUSTICE

JPMorgan Chase Agrees to $13 Billion Settlement with U.S.

By Steve Stanek

After much back and forth, JPMorgan Chase agreed in November to pay $13 billion to settle federal charges that it sold "mortgage-backed securities" without properly informing buyers of their highly risky nature. The bank did not admit wrongdoing in agreeing to settle.

The $13 billion settlement is by far the largest of its kind in national history. It stems from the sale of bundles of mortgage-backed securities that were sold to investors, including Fannie Mae and Freddie Mac, the government-sponsored mortgage entities that were put into conservatorship after the housing market collapse in 2008.

Ironically, most of the government's allegations appear to center on the activities of two financial companies JPMorgan Chase rescued at the behest of the federal government as they headed for financial ruin. JPMorgan Chase took over their liabilities when it took over those companies.

A settlement was announced in late October but then appeared to be falling apart as negotiations continued. One part of the agreement began pro-

DEAL, p. 2

JPMorgan Chase Agrees to $13 Billion Settlement with U.S.

Continued from page 1

ceeding as announced, though.

In late October JPMorgan Chase announced it had agreed to pay two settlements totaling $5.1 billion to the Federal Housing Finance Agency.

The larger of the settlements, valued at $4 billion, is over mortgage-backed securities sold to Fannie Mae and Freddie Mac. Those securities went bad, resulting in billions of dollars of losses for Fannie and Freddie. The FHFA, which serves as conservator for Fannie and Freddie, says the quality of the mortgages was misrepresented at the time of sale. The remaining $1.1 billion resolves Fannie's and Freddie's repurchase claims associated with whole loan purchases.

"The satisfactory resolution of the private-label securities litigation with J.P. Morgan Chase & Co. provides greater certainty in the marketplace and is in line with our responsibility for preserving and conserving Fannie Mae's and Freddie Mac's assets on behalf of taxpayers. This is a significant step as the government and J.P. Morgan Chase move to address outstanding mortgage-related issues," said FHFA Acting Director Edward J. DeMarco in a statement. "Further, I am pleased that a resolution of single family, whole loan representation and warranty claims could be achieved at the same time. This, too, will have a beneficial impact for taxpayers and the housing finance market."

"Today's settlements totaling $5.1 billion are an important step towards a broader resolution of the firm's [mortgage-backed securities]-related matters with governmental entities, and reflect significant efforts by the Department of Justice and other federal and state governmental agencies," said JPMorgan Chase in a statement.

Punished for Bear Stearns

That left $8 billion of the settlement up in the air. The reason behind the huge price tag for the overall settlement grabbed the attention of financial analysts, who say it could set a dangerous precedent. Most of the government's complaints center on mortgage business that JPMorgan Chase took over when it acquired the Bear Stearns Companies, a major investment bank and securities firm that collapsed in 2008 at the start of the financial crisis and recession.

The federal government pressured JPMorgan Chase to rescue Bear Stearns. JPMorgan Chase initially agreed to pay $2 a share but under pressure ended up paying $10 a share for Bear Stearns assets and operations.

JPMorgan Chase also rescued mortgage lender Washington Mutual at the request of the government, and some of the Washington Mutual activities also were used to pressure a JPMorgan Chase settlement.

Analysts say the government is setting a bad precedent by punishing JPMorgan Chase for the actions of firms it rescued at the behest of the government.

"The feds strong-armed JPMorgan Chase into absorbing Bear Stearns, and now they are penalizing them for things Bear Stearns had done before the takeover—specifically, peddling low-quality, high-risk mortgage-backed securities. Never mind the fact that the primary impetus to crank out large volumes of such shoddy (and eventually 'toxic') securities came from Uncle Sam, particularly the Department of Housing and Urban Development which pressured Fannie Mae and Freddie Mac to increase the number of risky mortgages that were the main ingredient of mortgage-backed securities," wrote *Forbes* columnist Mark W. Hendrickson in his November 2 column.

> **"The feds strong-armed JPMorgan Chase [above] into absorbing Bear Stearns [below], and now they are penalizing them for things Bear Stearns had done before the takeover—specifically, peddling low-quality, high-risk mortgage-backed securities."**
>
> MARK W. HENDRICKSON
> COLUMNIST, *FORBES*

Billions More at Stake

In addition to the financial settlement, Attorney General Eric Holder has made clear the government could pursue criminal charges despite the settlement. JPMorgan Chase has reported setting aside an extra $23 billion for future settlements and legal fees.

On November 3, Bloomberg News reported JPMorgan Chase has disclosed at least eight separate Department of Justice investigations against the company.

Steve Stanek (**sstanek@heartland.org**) *is a research fellow at The Heartland Institute and managing editor of two Heartland publications,* Budget & Tax News *and* FIRE Policy News.

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No Crime Committed, But Feds Seize Account

Continued from page 1

your milk money. But that's exactly what the government did to Terry and Sandy."

Like most grocery store owners, the Dehkos receive cash every day from their customers. Their common-sense practice always has been to avoid letting too much cash accumulate in their store. Moreover, their insurance policy specifically limits coverage for theft or other loss of cash to $10,000—a common provision for small-business policies. So the Dehkos routinely have deposited amounts smaller than $10,000 in a nearby bank.

A New Violation Called 'Structuring'

Over the past several years, the federal government has been collecting vast amounts of private information about Americans, including entrepreneurs like the Dehkos who deal in cash. In 2001, the Patriot Act amended federal law to make it easier for the government to seize money and other private property through civil forfeiture. Federal law requires banks to report cash transactions above $10,000, and it is illegal to "structure" cash deposits for the purpose of avoiding this requirement.

In 2010, the IRS visited the Dehkos and reviewed their banking practices. In 2012, the IRS conducted an anti-money-laundering examination of their store, thoroughly reviewing their books and policies, and gave the Dehkos a clean bill of health. After the audit, the IRS sent them a letter stating "no violations [of banking laws] were identified."

But nine months later, the IRS obtained a secret warrant and cleaned out the Dehkos's entire bank account (more than $35,000) on the grounds their frequent cash deposits—deposits of which the IRS should have been well aware when it issued its clean bill of health—violated federal "structuring" law. The government never charged Terry and Sandy with any crime and refuses to return their money.

No Charges or Hearing

The Dehkos are still waiting for a hearing before a judge. Civil forfeiture allows the government to violate due process by seizing private property without convicting or even charging the individuals with wrongdoing. The government then pockets the proceeds while providing no prompt way to get a court to review the seizure.

"Last year alone, the government took in more than four billion dollars in forfeiture money," said IJ attorney Larry Salzman. "Taking money from innocent people like Terry and Sandy is wrong. Thankfully, the Dehkos are prepared to go all the way to the Supreme Court if that's what it takes to vindicate the right to private property for Americans everywhere."

"We didn't do anything wrong," said Sandy Dehko. "That's why we teamed up with the Institute for Justice, to protect the rights of all Americans against civil forfeiture."

The Institute for Justice has documented billions of dollars of property the federal, state, and local governments have seized from persons never convicted of a crime or even charged with one. In 2010 the IJ published "Policing for Profit: The Abuse of Asset Forfeiture," which notes, "Americans are supposed to be innocent until proven guilty, but civil forfeiture turns that principle on its head. With civil forfeiture, your property is guilty until you prove it innocent."

"[T]he IRS obtained a secret warrant and cleaned out the Dehkos's entire bank account (more than $35,000) on the grounds their frequent cash deposits ... violated federal 'structuring' law. The government never charged [them] with any crime and refuses to return their money."

John Kramer is vice president for communications at the Institute for Justice.

INTERNET INFO

"Policing for Profit: The Abuse of Asset Forfeiture," by Marian R. Williams, Ph.D., Jefferson E. Holcomb, Ph.D., Tomislav V. Kovandzic, Ph.D., and Scott Bullock, Institute for Justice: **http://heartland.org/policy-documents/policing-profit-abuse-civil-asset-forfeiture**

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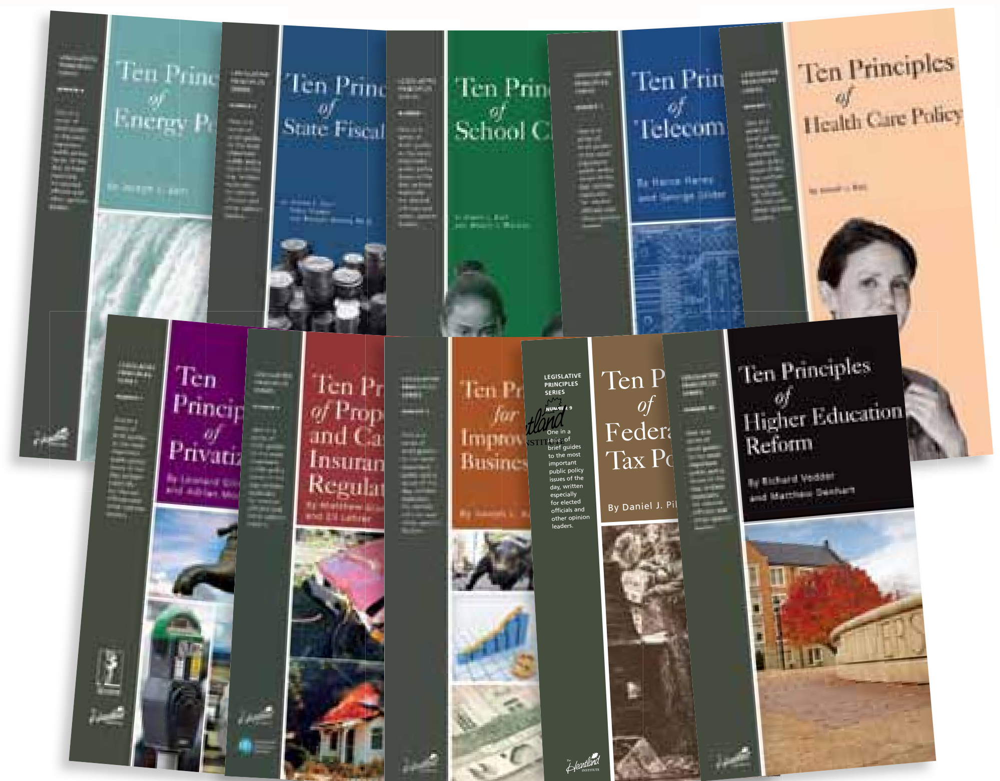

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How Much Longer Will the Dollar Be the World's Reserve Currency?

Editor's note: China's official press agency in October called for ending the U.S. dollar as the world's reserve currency.

In an English-language editorial, China's Xinhua news agency said the world should consider a new reserve currency "that is to be created to replace the dominant U.S. dollar, so that the international community could permanently stay away from the spillover of the intensifying domestic political turmoil in the United States."

China is the largest foreign holder of U.S. government debt, with about $1.3 trillion of Treasury bonds in its portfolio. China is also a huge buyer of gold. Some analysts believe China's government is building gold reserves to create its own gold-backed currency.

This news makes the following commentary, posted October 12 at the Mises.org Web site, and used with permission, especially timely.

By Patrick Barron

We use the term "reserve currency" when referring to the common use of the dollar by other countries when settling their international trade accounts. For example, if Canada buys goods from China, it may pay China in U.S. dollars rather than Canadian dollars, and vice versa. However, the foundation from which the term originated no longer exists, and today the dollar is called a "reserve currency" simply because foreign countries hold it in great quantity to facilitate trade.

The first reserve currency was the British Pound Sterling. Because the pound was "good as gold," many countries found it more convenient to hold pounds rather than gold itself during the age of the gold standard. The world's great trading nations could hold pounds rather than gold, with the confidence that the Bank of England would hand over the gold at a fixed exchange rate upon presentment.

Toward the end of World War II the U.S. dollar was given this status by international treaty following the Bretton Woods Agreement, with the promise that the Fed would not inflate the dollar and stood ready to exchange dollars for gold at $35 per ounce.

U.S. Called to Account

Unfortunately, the Fed did not keep that commitment. It was called to account in the late 1960s, and to his everlasting shame, President Richard Nixon took the United States "off the gold standard" in September 1971. Nevertheless, the dollar was still held by the great trading nations, because there was no other currency that could match the dollar, despite the fact that it was "delinked" from gold.

Two characteristics make a currency useful in international trade: one, it is issued by a large trading nation; and, two, it holds its value vis-à-vis other commodities over time.

Although the dollar was being inflated by the Fed, thus losing its value vis-à-vis other commodities over time, there was no real competition. The German Deutsche mark held its value better, but German trade was a fraction of U.S. trade, meaning holders of marks would find less to buy in Germany than holders of dollars would find in the United States. In addition, the United States was seen as the military protector of all the Western nations against the communist countries for much of the postwar period.

Other Monies Being Used

Today we are seeing the beginnings of a change. The Fed has been inflating the dollar massively, causing many of the world's great trading nations to use other monies upon occasion.

[Even companies do so.] I have it on good authority, for example, that DuPont settles many of its international accounts in Chinese yuan and European euros. There may be other currencies that are in demand for trade settlement by other international companies as well.

In spite of all this, one factor that has helped the dollar retain its reserve currency demand is that the other currencies have been inflated, too. For example, Japan has inflated the yen to a greater extent than the dollar in its foolish attempt to revive its stagnant economy by cheapening its currency. The monetary destruction disease is by no means limited to the United States.

The dollar is very susceptible to losing its vaunted reserve currency position by the first major trading country that stops inflating its currency. There is evidence China understands what is at stake; it has increased its gold holdings and has instituted controls to prevent gold from leaving China.

Should the world's second-largest economy and one of the world's greatest trading nations tie its currency to gold, demand for the yuan would increase and demand for the dollar would decrease. In practical terms this means the world's great trading nations would reduce their holdings of dollars, and dollars held overseas would flow back into the U.S. economy, causing prices to rise. How much would they rise? It is hard to say, but keep in mind that there is an equal number of dollars held outside the United States as there are inside the nation.

Yellen's Dangerous QE Fixation

President Barack Obama's [nomination] of career bureaucrat Janice Yellen as chairman of the Federal Reserve Board is evidence the U.S. policy of continuing to cheapen the dollar via quantitative easing will continue. [If confirmed], her [appointment] increases the likelihood that the demand for dollars will decline even further, raising the prospect of much higher prices in the United States as demand by trading nations to hold other currencies as reserves for trade settlement increases.

Perhaps only such non-coercive pressure from a sovereign country like China can wake up the Fed to the consequences of its actions and force it to end its quantitative easing policy.

Patrick Barron is president of PMG Consulting, LLC and has been a consultant to the banking industry since 1985.

Financial Transactions Taxes Are a Drag on Economic Activity

By Matthew Glans

Since the 2007–08 financial crisis, legislators in the United States and across the world have proposed new taxes on certain financial transactions, including securities trading and stock transactions.

For proponents of these financial transactions taxes, commonly known as "Robin Hood" taxes, the goal is twofold: raise revenue for the national governments and slow down short-term speculative trading, which they believe causes unnecessary market volatility.

While proposals to create a financial transactions tax have yet to gain significant momentum in the United States, several countries in Europe already have implemented such a tax or are strongly considering one.

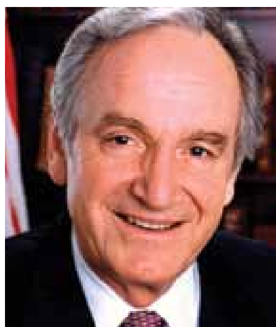
In August 2012, France imposed a new 0.2 percent transactions tax on certain stock purchases. Early in 2013, 11 member nations of the European Union created a new tax of 0.10 percent—or 10 basis points—to be imposed on stock and bond trades and 0.01 percent, one basis point, on derivatives.

Two Tax Proposals

Two pieces of legislation that would create a financial transactions tax are currently being considered in Congress.

The first, reintroduced by Sen. Tom Harkin (D-IA) and Rep. Peter DeFazio (D-OR) in late February 2012, is the Wall Street Trading and Speculators Act. It would impose a 0.03 percent, or three basis points, tax on stock and bond trades.

A second bill, proposed by Rep. Keith Ellison (D-MN), goes even farther. Ellison's Inclusive Prosperity Act of 2013 would impose a tax of 0.50 percent, 50 basis points, on stock trades in an effort to raise additional billions of dollars in new tax revenue.



Tom Harkin
U.S. Senator - IA

Peter DeFazio
U.S. Representative - OR

Keith Ellison
U.S. Representative - MN

Proponents of transactions taxes argue markets can absorb them with little disruption, with the burden being borne by speculators. Opponents respond that these new taxes would harm financial markets by decreasing trading volume. This, in turn, would result in less revenue than governments anticipate.

Opponents also note transactions taxes would lower the values of pensions, retirement savings accounts, annuities, charitable trusts, and money market funds.

Lack of Evidence

Hilary Till, co-editor of the book *Intelligent Commodity Investing* and a policy advisor to The Heartland Institute, which publishes *FIRE Policy News*, said she doubts a transactions tax would achieve its stated goals.

"Regarding the Inclusive Prosperity Act of 2013, which proposes to 'impose a tax on certain trading transactions [in order] to strengthen our financial security, reduce market volatility, expand opportunity, and stop shrinking the middle class,'" said Till, "I would think the onus would be on the sponsors to prove that such a taxation policy could actually achieve all of these goals. I certainly am unaware of such evidence."

Harvard economics professor Kenneth Rogoff argued in an article on the European tax reforms that ordinary workers, not banks, would bear the brunt of the transactions tax.

"Higher transactions taxes increase the cost of capital, ultimately lowering investment," Rogoff wrote. "With a lower capital stock, output would trend downward, reducing government revenues and substantially offsetting the direct gain from the tax. In the long run, wages would fall, and ordinary workers would end up bearing a significant share of the cost."

Less Liquidity

Jeffrey V. McKinley, CPA and co-founder of Senex Solutions, LLC, says a transactions tax likely would raise the costs of investing and slow the economy.

"Historical experiences with transactions taxes in other countries have led to declines in liquidity, and most fall far short of their estimated revenue generation," he said. "In fact, a study showed that the recently proposed bills, if enacted, would lead to the total elimination of all volume in six U.S. futures contracts including the S&P 500.

> **"The 'tiny' tax that legislators speak of is actually a 12,000 percent increase in trading costs for most professional trading firms. This disruption to the marketplace would have a devastating effect ..."**
>
> JEFFREY V. MCKINLEY, CPA
> CO-FOUNDER, SENEX SOLUTIONS, LLC

"The 'tiny' tax that legislators speak of is actually a 12,000 percent increase in trading costs for most professional trading firms. This disruption to the marketplace would have a devastating effect on price discovery and risk transfer mechanisms in the economy, both in the U.S. and worldwide," McKinley said.

The tax also would raise the cost of capital for corporations and other entities that issue stocks and bonds while reducing returns for investors.

'A Blunt Instrument'

"The rationale is to raise revenue and reduce trading activity that some legislators believe is harmful to the marketplace and economy," McKinley said. "As [Vermont Senator] Bernie Sanders has stated: 'This bill will reduce gambling on Wall Street [and] encourage the financial sector to invest in the job-creating productive economy.'

"Those terms of 'gambling' and investing in 'job-creating productive economy' are extremely vague terms and concepts," said McKinley. "This is reflective of the danger of something like a transactions tax. A broadly applied tax is a very blunt instrument to combat a supposed market abuse."

McKinley said speculation plays an important role in managing risk and creating liquidity in the marketplace. Instead of imposing a tax to disrupt this activity, he said, the government should focus on real spending reform.

"Politicians are looking in the wrong direction by pursuing new taxes," said McKinley. "They need to focus on cutting spending. Since 1948, the government has increased spending per individual in inflation-adjusted dollars by 500 percent. The size of government needs to shrink."

Matthew Glans (**mglans@heartland.org**) *joined the staff of The Heartland Institute in November 2007 as legislative specialist for insurance and finance. In 2012 Glans was named senior policy analyst.*

COMMENTARY

The New Vicious Cycle of Student Loan Debt

By Tom Toth

Generally, the idea of going to college is not to just get a job but to begin a career. School loans are assumed to be worth the investment because of all the businesses waiting to accept entry-level graduates into their companies with open arms, offering good salaries, health, eye, and dental insurance, and Christmas bonuses.

Of course, these assumptions were built before the one-two punch of a heavy recession and Obamacare hit America.

As most recent college graduates can tell you, the job market is not so flowery. A recent study out of Rutgers University found that among the graduating classes from 2006 to 2011, only 51 percent are employed full-time and a whopping 11 percent are unemployed, far above the current 3.8 percent unemployment rate for all college graduates over the age of 25.

> **"Health care premiums can't pay student loan debt. Only paychecks can do that. Those who need Obamacare the least will pay the most for it."**

Waste of Money for Many

Perhaps a bigger problem for new graduates than unemployment is underemployment. The U.S. Federal Reserve Bank of New York reported recently 44 percent of recent graduates have jobs they would have qualified for before going to college and accumulating student debt.

These figures mean, for students who take loans, 44 of 100 graduates will be stuck paying off an average balance of $24,301 without any equity (a graduate-level job and salary) to show for it. According to the U.S. Department of Education, within three years of leaving school 14.7 percent of these loans default and for every loan that defaults at least two more borrowers become delinquent.

If large percentages of student loans are defaulting, millions of people will face crippling credit rating penalties that result in the inability to finance homes, purchase vehicles, and engage in the marketplace. New borrowers need businesses willing and able to invest in college graduates.

Situation May Become Worse

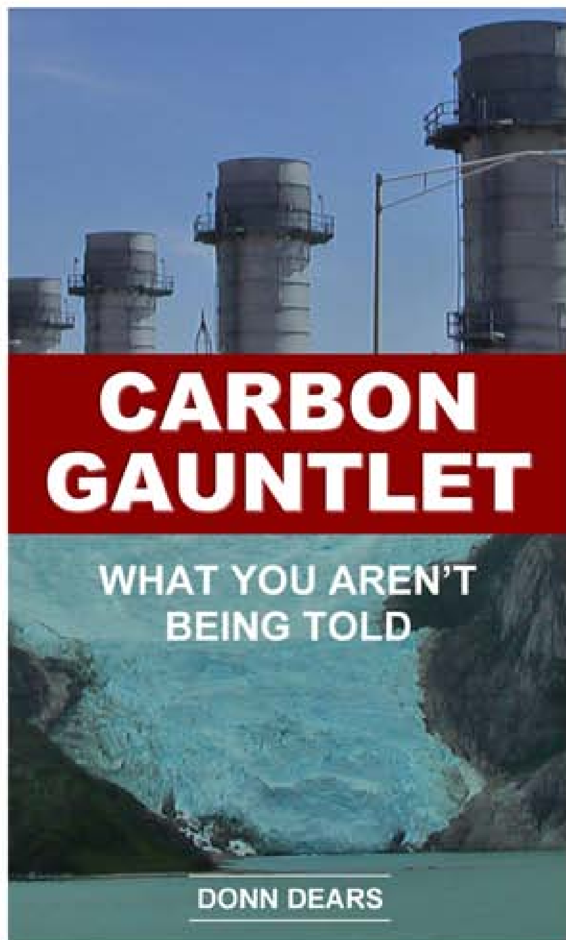
The economy and job market's recovery from the 2008 recession have trickled at an agonizingly slow pace—and it might get worse before it gets better.

The president recently gave businesses a one-year exemption from Obamacare's insurance mandate. But what about next year? In 2014, businesses will be required to participate in hugely expensive insurance programs that will prevent them from committing to as many full-time, entry-level employees.

Obamacare's unintended consequences reach far and wide. Nobody is hit harder by these consequences than the classes of graduates who will enter a post-recession job market that will be worse than it was when they began school.

Health care premiums can't pay student loan debt. Only paychecks can do that. Those who need Obamacare the least will pay the most for it. The cost may be more dramatic and far-reaching than anyone in 2010 may have ever guessed.

Tom Toth (**ttoth@getliberty.org**) *is the social media director for Americans for Limited Government.*



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ANALYSIS

Transactions Tax Likely to Cause More Damage to Financial Markets

Editor's note: This is the second part of a two-part article on damaging new taxes that some federal legislators are considering imposing on investors and entrepreneurs. Part 1 can be found here: **http://news.heartland.org/newspaper-article/2013/09/27/tax-bills-pose-big-threats-investors-little-gain-government.**

Last month's article discussed "carried interest" taxation. Carried interest, also known as a profits interest, is a business arrangement where a partner receives a share of the income of the business venture in exchange for providing services. Unlike other partners, carrying partners provide services and do not have to contribute capital, nor do they necessarily have to be allocated any of the losses. This is where we get the term "carried," because the other partners who provide all of the capital for the venture are figuratively "carrying" the profits interest partner.

Here in part two the focus turns to proposals to impose taxes on financial transactions.

"The concept of a financial transactions tax was initially proposed by John Maynard Keynes in 1936 in an attempt to curb speculation, and again in 1972 by economist James Tobin, namesake of the Tobin Tax."

By Jeffrey V. McKinley

In addition to "carried interest" taxation, another tax threat to the financial industry is the proposed financial transactions tax, sometimes called a "Robin Hood" tax, the idea being that it takes from the rich.

The financial crisis and subsequent bailout of banks and brokerage and trading firms created a backlash against those companies and calls to have them "pay for the crisis they caused and the bailouts they received." One method to accomplish this and other goals is to impose a tax on financial transactions. Bills doing this have been introduced in committee in both the U.S. Senate and the House.

Both bills are titled the Wall Street Trading and Speculators Tax Act, and both would impose a 0.03 percent excise tax on stocks, bonds, and derivatives. Proponents claim the measures are needed to raise revenue. They project revenues of $352 billion in 10 years as well as promising they would reduce the volatility of markets.

Proponents of the transactions tax claim some short-term traders harm the markets with their rapid buying and selling, primarily by increasing volatility. Even if there were some market participants who through their short-term trading disrupt the market, which is debatable, a tax would be a very blunt instrument to combat this supposedly harmful activity. Moreover, it runs the real danger of harming other beneficial market participants such as arbitrageurs who play a vital function of providing liquidity by weaving together interrelated markets worldwide.

Further, these claims of being able to reduce volatility through a transactions tax are questionable as many studies have concluded these types of taxes do not reduce volatility and in some cases end up increasing volatility.

"We would all be better off if politicians would spend their time looking to reduce government spending as opposed to adding complexity to the tax code and disrupting business activity as they seek out new revenue sources."

Long History of Proposals

Financial transactions taxes have been proposed pretty much since the creation of organized trading and investing itself. The concept of a financial transactions tax was initially proposed by John Maynard Keynes in 1936 in an attempt to curb speculation, and again in 1972 by economist James Tobin, namesake of the Tobin Tax.

Tobin suggested a targeted tax on foreign currency transactions would reduce volatility in the marketplace after the 1971 closing of the gold window, which ended the convertibility of dollars into gold and resulted in floating exchange rates.

The United States has had other proposals. In 1987, House Speaker Jim Wright (D-Texas) proposed a fee of 0.25 percent to 1 percent on both the buyer and the seller in each securities transaction. In 1990, President George H.W. Bush proposed a 0.5 percent tax. In 1993, the Clinton Administration proposed a tax of a fixed amount, 14 cents, on futures transactions. And now we have the 0.03 percent tax proposed by Sen. Tom Harkin (D-Iowa) and Rep. Peter DeFazio (D-Oregon).

Financial transactions taxes also have been the preferred revenue-raiser for multiple bills to fund measures ranging from boosting employment to access to dentists to climate change mitigation.

Harmful Experience Starting in 1960s

The United States has experienced the harmful effects of transactions taxes in the past. In the 1960s, the Eurobond market was emerging with New York being the center of activity. But in 1963, the U.S. Interest Equalization Tax was passed, placing a tax that ranged from 1.05 percent to 22.5 percent on bonds depending on their maturity. Over the next seven years, Eurobond issues in London increased more than 18-fold while New York lost jobs in that sector. The tax was repealed in 1974, but it was too late for New York to reestablish the lead for the market.

In 1984, Sweden imposed taxes on securities transactions at a rate of 0.5 percent and then doubled the rate to 1 percent in 1986. The apparent impetus for the tax was popular envy of the salaries being earned by the country's young financial professionals. The effects on the stock markets in Sweden were pronounced. Tax revenues amounted to only about one-thirtieth of the amount forecast. After the doubling of the tax rate, 60 percent of the volume of the most active 11 stocks traded in Sweden shifted to London, and fixed-income trading dropped 85 percent. The taxes were abolished in 1991, and trading volume and tax revenues rose significantly.

An October 2011 report from the CME Group summarized 17 studies of the effects of a transactions tax. Of those 17 reports, six examined the impact on tax revenues. Four of the six showed tax receipts below expectations, one showed tax receipts higher than expected, and one showed only temporary success generating higher tax revenues.

Ten of the studies considered the impact on liquidity, with nine of them showing lower liquidity. The tenth liquidity study was inconclusive.

Results were similar for the studies that considered volatility. Of the nine reports

that studied volatility, seven showed higher volatility, one was inconclusive, and one showed no effect.

Serious Damage to Futures Industry

Now let's turn our attention to the impact a financial transactions tax would have on futures trading given its special importance to the local economy of Chicago and the global economy in general.

The Chicago-based CME Group comprises 98 percent of total futures trading in the U.S. and 6 percent of total corporate tax receipts of Illinois. The 6 percent figure does not count the revenue streams from trading firms, individual traders, and businesses affiliated with trading. In short, vibrant futures trading is important in many aspects.

The current proposals for a 0.03 percent tax are particularly detrimental to futures trading. This point is lost on the proponents of the tax. This oversight is primarily due to the scoring models used to assess the potential effects on the marketplace and amount of tax revenue. These models are based on securities trading, not futures trading, and they grossly underestimate the elasticity of demand of futures markets primarily due to global competition.

Anyone familiar with the modern-day trading environment understands that access to another market in the far corners of the world is simply a mouse click away. Impose taxes on one market, and volume will switch almost instantly to markets with lower taxes.

A study conducted in 2012 to assess the impact of a tax of 0.02 percent on futures transactions predicted not just a drop in volume if the tax were implemented, but the total elimination of all volume in six U.S. futures contracts including the S&P 500. Other U.S. futures contracts would suffer large drops in volume.

A 12,000% Tax Increase

This is understandable, as a tax of 0.03 percent, touted as a tiny tax by some, is an increase of 12,000 percent in transaction costs for some market participants. For example, a Treasury Note contract with a notional value of $100,000 would have a tax imposed of $30. Most professional traders are paying around 25 cents for such contracts. The tax would force many firms to instantly shut down. At the very least, the tax would be hugely disruptive as those firms shift their volume to exchanges outside of the United States.

A financial transactions tax, like the proposal to change the way carried interest is taxed, would be very damaging to the marketplace. At the same time, such taxes likely would not bring in the anticipated revenue or the market calmness their proponents seek.

We would all be better off if politicians would spend their time looking to reduce government spending as opposed to adding complexity to the tax code and disrupting business activity as they seek out new revenue sources.

Jeffrey V. McKinley, CPA is co-founder of Senex Solutions, LLC.

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HISTORY LESSON

The Resiliency of the U.S. Futures Industry: A Chicago Perspective

By Hilary Till

Financial professionals are well aware that the ongoing implementation of the Dodd-Frank Act will likely cause changes to market structure, including in the futures markets. Should market participants be concerned?

The short answer is not necessarily, given that the history of U.S. futures trading has been one of responding to constant adversity, man-made or otherwise, through innovation.

"[W]e know Chicago's century-plus heritage of financial risk-taking has served the city well."

Beginnings of U.S. Futures Trading

Arguably, the story of U.S. futures markets has largely been one of innovation in Chicago with several notable exceptions.

Once Chicago became a transportation hub and grain terminal in the mid-nineteenth century, grain merchants had to figure out how to manage the price risk for their accumulating volume of grain inventories. That solution was the development of a formalized exchange: the Chicago Board of Trade (CBOT).

At the time, Chicago was already a well-established center of financial risk-taking because of the land speculation that had occurred in Illinois in the 1830s during the building of a crucial canal that ultimately linked productive Illinois farmland to major population centers.

'No Intent or Design'

In a pattern that would repeat itself, the Chicago Board of Trade's existence was the "result of evolution, not intent or design," wrote John Stassen, a derivatives legal expert, in a 1982 law journal article. "The Chicago Board of Trade was created by businessmen as a commercial exchange for businessmen—grain merchants—who needed some order in a world of chaos, and some relief from a hostile judicial system which only reluctantly enforced businessmen's bargains. … [T]he courts in Illinois, as in most states, adhered to old English precedent which places damages for expected profits on a par with usury," explained Stassen.

"The CME's Everette Harris noted in 1970 … that an enduring philosophy of the CME has been an acceptance of the possibility of failure in its new product ventures."

Granted, merchants in Chicago were not the originators of the concept of futures contracts. In his 1971 textbook on commodity markets, Prof. Thomas Hieronymous of the University of Illinois noted: "The concept of futurity in contractual arrangements is as old as commerce. The rules of futures trading certainly date back to the medieval fairs of France and England which were large and complex by the 12th Century."

"[B]ut as a practical matter," Hieronymous continued, "we need look no further back than the frontier of the U.S. in the mid-19th century for the origin of modern futures trading." He wrote the "circumstances of the frontier, particularly in the grain trade, were the catalyzing agent out of which futures trading grew."

Hieronymous quoted an 1896 academic journal describing the business conditions of the mid-nineteenth century: "Untrammeled by business traditions of past centuries … the trade of this country has unconsciously adopted new and direct means for attaining its ends. There has been little 'history' or 'evolution' about the process, for the practical mind of the business man has simply seized the most direct method of 'facilitating' business, a course forced on him by the constantly increasing size of transactions."

'With Crisis Comes Opportunity'

With hindsight, we know Chicago's century-plus heritage of financial risk-taking has served the city well.

For example, it was Chicago futures traders who responded successfully to the dislocations that were caused by the collapse of the Bretton Woods system of fixed foreign-exchange rates, which President Richard Nixon unilaterally ended in a surprise announcement on August 15, 1971. The Bretton Woods system had been established near the end of the Second World War and was based on the U.S. dollar being redeemable for gold in foreign exchange. In his surprise announcement, Nixon said America would end the convertibility of dollars to gold.

The Chicago exchanges developed financial hedging instruments in both currencies and interest rates in the 1970s and 1980s. This development can be seen as a classic case of "with crisis comes opportunity."

Given that the launch of financial futures trading in Chicago became hugely successful, it may be surprising to read about the early skepticism that greeted these efforts, as discussed in 1994 by Leo Melamed, chairman emeritus of the Chicago Mercantile Exchange (CME) Group, Inc.

According to Melamed, "Some … thought it ludicrous that [in the early 1970s] a 'bunch of pork belly crapshooters' would dare" launch futures contracts on foreign exchange.

In fact, former CME chairman Jack Sandner would later proudly explain, "Financial futures were spawned out of the belly of the hog."

Constantly Innovating

The maxim "with crisis comes opportunity" has been a constant for the Chicago futures exchanges and predates the collapse of the Bretton Woods system.

For example, in the 1960s the CME had to develop new futures contracts because its mainstay futures contracts in eggs and butter had become obsolete. "Technological changes had transformed the production and distribution of butter and storage eggs from seasonally produced commodities with classical production and price cycles to basically new and different products in their production, price, and distribution patterns. The economic necessity of hedging markets provided by a futures market had greatly diminished," recalled Everette Harris, former president of the CME, in 1970.

What was the response of the futures industry to this crisis? Innovation. Starting in the early 1960s, the CME began introducing livestock futures contracts. As of 1980, the live cattle futures contract had become the largest contract on the exchange, according to a speech at the time by Leo Melamed.

NYMEX Another Innovator

Admittedly, Chicago has not been the only center of innovation in U.S. futures market development. In the 1970s, for example, the New York Mercantile Exchange (NYMEX) had arguably faced possible extinction when its mainstay contract, the Maine potato, lost credibility during scandals in 1976 and 1979.

Fortuitously, the NYMEX responded to an

<<The Chicago Mercantile Exchange (lower right)
The Chicago Board of Trade>>

emerging opportunity. The structure of the oil industry had changed after numerous nationalizations in oil-producing countries. This forced some oil companies to shift from long-term contracts to the spot oil market, according to Pulitzer Prize-winner Daniel Yergin in his book, *The Prize*.

With the structure of the oil industry changing, an economic need for hedging volatile spot oil price risk emerged, to which the NYMEX responded with a suite of energy futures contracts, starting with the heating oil contract in 1981.

According to Yergin, "The initial reaction to the futures market on the part of the established oil companies was one of skepticism and outright hostility. … A senior executive of one of the … [major oil companies] dismissed oil futures 'as a way for dentists to lose money.'" But, Yergin noted, the practice of futures trading "moved quickly in terms of acceptability and respectability." Price risk meant many businesses had to participate in the futures markets.

Electronic Trading Competition Response

Later, new threats confronted the established U.S. exchanges. The CBOT, CME, and NYMEX had to face up to competitive threats resulting from electronic trading. The starkest example came from Europe in 1998.

At that time, the electronic exchange, the EUREX (DTB), successfully wrested control of the 10-year German government bond futures contract, the Bund contract, from the (then) open-outcry LIFFE exchange in London with a "price war on fees."

This unprecedented victory of an all-electronic venue accelerated change in Chicago. Soon thereafter both the CBOT and CME embraced concurrent open-outcry and electronic trading. Under pressure from ICE Futures Europe, an innovative electronic futures exchange, the NYMEX listed its energy futures contracts on the CME's Globex electronic trading system in 2006.

In the late 1990s, worries about Chicago's continued competitiveness continued unabated. According to Melamed in his 2009 autobiography, "the only way to prepare … [the CME] for the twenty-first century" was to demutualize; a member-driven organization would be too slow in its decision-making. Therefore, the CME went public in 2002, becoming the first U.S. financial exchange to do so.

By 2006, the Chicago Mercantile Exchange's trading volume "exceeded 2.2 billion contracts—worth more than $1,000 trillion—with three-quarters of … trades executed electronically," according to the CME.

In 2007 the CBOT merged into cross-town rival CME, and in 2008, the NYMEX merged into the combined Chicago exchange.

Confirming Melamed's concern for how important the global environment could become, *Futures Industry* magazine reported last year that two-thirds of all futures volume was traded outside the United States.

Adversity an Essential Element

Given the narrative above, perhaps one does not need to emphasize how much adversity is an essential part of the story on the evolution of the futures industry. After all, adversity is the story of trading itself. Author Ralph Vince stated in 1992 that trading "requires discipline to tolerate and endure emotional pain to a level that 19 out of 20 people cannot bear. … Anyone who claims to be intrigued by the 'intellectual challenge of the markets' is not a trader. The markets are as intellectually challenging as a fistfight. … Ultimately, trading is an exercise in self-mastery and endurance."

Perhaps the same can be said about product development in the futures markets, whose history is largely one of overcoming failure and skepticism.

The CME's Everette Harris noted in 1970, in words that still ring true today, that an enduring philosophy of the CME has been an acceptance of the possibility of failure in its new product ventures: "Necessity is the mother of invention. Beginning in the early fifties … [CME] members have vigorously researched, tested, and promoted many new contracts for futures trading. . . . Some have succeeded and some have failed, but fear of failure has not impeded progress."

Always Resilient, Innovating

In this brief review of the history of U.S. futures markets, one does get a sense of the resiliency of these institutions, in constantly responding to adversity, from their earliest days and well into the present.

Based on this history, one would expect that resiliency to continue, not through some "designing intelligence," but rather through a willingness to continue to innovate through trial-and-error efforts.

Arguably, this insight may be the most important lesson for emerging new financial centers, as well.

Hilary Till provides advice on risk-management and derivatives trading issues through Premia Risk Consultancy, Inc. In addition, she is a co-founder and principal of Premia Capital Management, LLC and co-editor of Intelligent Commodity Investing, *a bestseller for Risk Books.*

"Given that the launch of financial futures trading in Chicago became hugely successful, it may be surprising to read about the early skepticism that greeted these efforts …"

"In this brief review of the history of U.S. futures markets, one does get a sense of the resiliency of these institutions, in constantly responding to adversity, from their earliest days and well into the present."

Mich. No-Fault Auto Claims Are Costly, Study Shows

By Jarrett Skorup

Michigan legislators are considering reforming the state's automobile insurance laws in order to save drivers money while still providing robust coverage. Ill-conceived state mandates cause Michigan drivers to pay among the highest insurance costs in the nation for the coverage they receive.

The Citizens Research Council recently released a study examining why the system is so expensive. The details are complicated, but in the end it comes down to basic economics.

Michigan is unique among states in requiring personal injury protection coverage for all drivers, allowing those injured to sue at-fault drivers for bodily injury, and paying out unlimited medical benefits through catastrophic claims coverage (the next highest is New York, which limits payouts to $50,000).

More Claims, More Money

The report found Michigan residents make more claims requesting more money, and medical providers charge auto insurers more for care. This leads to higher prices.

> "Michigan residents make more claims requesting more money, and medical providers charge auto insurers more for care. This leads to higher prices."

"Accounting for both higher prices and higher usage, medical claims in Michigan cost auto insurers 57 percent more than claims for similar crashes in other states; consequently, automobile insurance premiums are 17 percent higher on average," the study stated. Holding price and medical care constant, the CRC said the average auto injury claim in Michigan should be $12,885; instead, it is $20,229.

Because of the state mandate for coverage, plus the fact that auto insurers are unable to negotiate the rates they are charged by medical providers who treat persons with auto accident claims, incentives are distorted across the state's insurance system. CRC found the claims from Michigan health providers are 24 percent higher than in other states, which inevitably leads to insurance companies paying more and passing the higher price on to consumers.

Claimants from the Michigan Catastrophic Claims Association more than doubled between 2002 and 2012, meaning insurance rates are heading upward and expected to skyrocket in the coming years.

Similar Care, Higher Prices

For every medical category, CRC found that compared to other state health care reimbursement programs, the medical costs associated with Michigan's no-fault coverage are higher. That is, health providers charge much more for the same care.

In Detroit, for example, the reimbursement for no-fault auto insurance is 352 percent higher than Medicare and 227 percent higher than workers' compensation insurance for an emergency room visit. In addition, for the 15 most common medical charges, no-fault insurance paid on average 190 percent more in Lansing and 193 percent more in Grand Rapids than Medicare, and 93 percent and 95 percent more than workers' compensation, respectively.

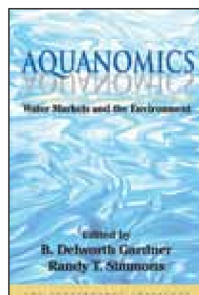
The report covers many areas and is fairly complex, but it makes clear the reason for high costs: Since coverage is mandatory and insurers cannot negotiate on price, incentives for consumers shopping for insurance and medical providers requesting pay are distorted. Properly aligning the costs and benefits of Michigan's insurance market will require reform laws by the state legislature.

Jarrett Skorup (**skorup@mackinac.org**) *is a research associate at the Mackinac Center for Public Policy.*

INTERNET INFO

"Medical Costs of No-Fault Automobile Insurance," Citizens Research Council of Michigan: **http://heartland.org/policy-documents/medical-costs-no-fault-automobile-insurance**

Bureaucracy vs. the Environment



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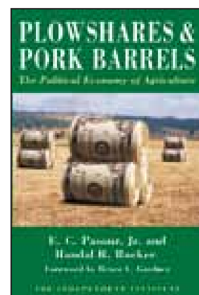

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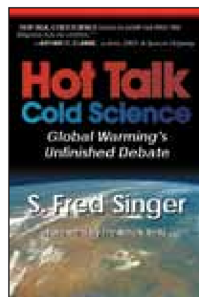

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The New Red Menace: Government Debt

By Burton A. Abrams

With the Obama White House and Congress having agreed in October to allow the Treasury Department to borrow money beyond the previous $16.7 trillion federal debt limit through February 7, Washington is girding for another battle over taxes and spending between Congress and the White House.

Regardless of the exact details, recent history teaches us the biggest loser likely will be the taxpayer.

After World War II, America's main concern for many decades was the so-called "red menace" of Communism and the Soviet Union. Now we're discovering the real red menace is the sea of red ink that Washington has been piling up—the national debt.

Benefits Today, Payments Tomorrow

The problem is mainly political: Washington's practice of providing benefits today while postponing payment until tomorrow.

To some degree we all know the story.

During the 70-year period of 1940 to 2010, gross federal debt increased from $43 billion (the equivalent of $670 billion in 2010 dollars) to more than $13.5 trillion—a 24-fold increase. Since then, it has increased at an even faster rate, hitting $16.2 trillion in November 2012 and more than $16.5 trillion today.

President Barack Obama has spoken passionately about the oppressive debt students incur in pursing their college degrees. On average, students graduating in 2013 were saddled with about $35,000 in debt. Obama should be more concerned about their share of the national debt, which now stands at more than $145,000 per taxpayer.

The reason we all should be concerned about the mounting debt is because there's no end in sight. The recent reduction in the budget deficit is no cause for celebration, as it is only temporary. As a result of many factors—including our aging population and the promises associated with Social Security, Medicare, and Obamacare—the government's annual deficits will continue far into the future, pushing the debt ever higher, unless major tax increases are enacted.

A Global Debt Pandemic

The United States is far from alone in the accumulation of debt. Many countries have accumulated even higher levels of debt relative to the size of their economies.

In fact, if we add up the net public debt of all the nations of the world—that is, gross debt minus money the governments owe themselves, such as Social Security trust fund obligations here in the United States—the average in 2009 amounted to 59.3 percent of GDP.

U.S. net public debt in 2009 was slightly lower: 58.9 percent of GDP. Japan's public debt, by contrast, stood at nearly 226 percent of GDP, Greece's at 144 percent, Italy's at 118 percent, and the United Kingdom's at 76.5 percent. China's public debt, meanwhile, was just 17.5 percent.

Although the United States looks comparatively healthy in the snapshot above, the truth is that only 35 of the 131 countries we studied had debt levels higher as a percentage of GDP than the United States—and many of those countries (think Greece) have suffered major economic meltdowns.

We all know where the United States is heading. A 2011 poll of the members of the National Association for Business Economics listed the federal budget deficit as the No. 1 threat facing the U.S. economy.

'Crowding Out' Investment

They're right. High levels of public debt slow economic growth for a number of reasons. When the government borrows money, it takes savings from the economy that otherwise could have been channeled into private-sector borrowing and investment. Economists refer to this as "crowding out" private investment.

Another cause for concern is the cost of interest on the debt. The U.S. Office of Management and Budget has forecast that in the year 2017 interest payments on the public debt will exceed the cost of Medicare.

The United States, in other words, is entering dangerous territory. Although deficit spending may provide short-term benefits, it's time to consider the long-term cost in slower economic growth.

Burton A. Abrams is a research fellow at the Independent Institute, professor of economics at the University of Delaware, and author of The Terrible 10: A Century of Economic Folly: **http://www.independent.org/store/book.asp?id=105**. *Used with permission of the Independent Institute and McClatchy Newspapers, where a version of the article first appeared.*

IN OTHER WORDS . . .

"Following the 2007 crisis, Congress passed Dodd-Frank, a massive tome of a bill that Americans were told would prevent a repeat of the financial meltdown. In fact, Dodd-Frank all but guarantees that big banks stay big and small banks struggle to compete. 'Dodd-Frank has not done enough to [corral] "too big to fail" banks and, on balance, the act has made things worse, not better,' said Richard Fisher, president of the Federal Reserve Bank of Dallas.

"Fisher's preferred solution was to break up the banks, but California Republican Rep. John Campbell introduced a bill that would require banks with $50 billion or more in assets to hold favor [sic] safer assets like long-term bonds. Doing that would help balance the banks' books while reducing the risk to taxpayers of another meltdown. But President Obama isn't likely to add Campbell's measure to his list of signature 'accomplishments.'

"By implying that some banks are 'too big to fail,' Dodd-Frank ensures a revolving door of back-scratching political activity between Wall Street and the government. These banks spend millions on lobbying federal legislators and regulators, so odds are they can count on government assistance during times of trouble. That encourages the largest banks to take unwise risks, knowing that American taxpayers provide a security blanket."

— *Editorial,* Washington Examiner, *October 27, 2013*

ANALYSIS

Fed Policies Pit Savings Versus Low Interest Rates

By David Howden

Five years after the worst financial crisis since the Great Depression, economists are still starkly divided regarding its causes. Perhaps this is not too surprising, as we are now more than 80 years past the Great Depression with little end in sight to the debate surrounding the causes of that downturn.

Most economists fall into one of two camps when identifying the origins of the imbalances that led to the current crisis. Austrian School economists are in the unique position of being able to reconcile these two camps, even while favoring the first explanation over the second.

Camp One: Rate Repercussions

The first camp, which includes most Austrian School economists, looks at the imbalances caused by central bank interest rate policy being set "too low for too long." In this view, artificially low interest rates allowed for erroneous capital investments after the dot-com bust of 2001 and continuing to the present time.

The Federal Reserve's artificial reduction of interest rates (to use the United States as a proxy for the Western world) put in motion two shifts in the economy. The first was the decrease in savings by Americans, and a corresponding consumption-led boom, what economist Ludwig von Mises called "overconsumption."

The second was the overall decrease in investment and production in the lower stages of the capital structure, with a corresponding increase in investment and production in the higher stages. This shift is what Mises termed "malinvestment." Note this shift does not represent an "overinvestment" in capital, as is commonly and erroneously claimed by non-Austrian economists, but instead a temporal shifting of productive activity from stages closer to consumption to those further away.

Specifically, we see malinvestment in the large-scale shift of capital away from manufacturing in favor of higher-order research and development. Overconsumption, on the other hand, is illustrated by the rise of consumer culture embodied by big-box stores and a plethora of shopping malls and outlet stores.

Camp Two: Savings Glutters

In the opposite camp are economists favoring the "excess savings view" or the "global savings glut hypothesis." These economists view the crisis as a result of current account surpluses, primarily in Asian countries, having led to financial imbalances in Western economies.

As consumers consumed more but the economy restructured itself away from producing consumer goods, an increase in imports was inevitable. As luck would have it, developing countries—especially in Asia—were in the reverse position of the United States, as years of financial underdevelopment had left many of them with immature financial markets. These Asian countries also proved to be low-cost producers of many products.

As Americans increased their imports from these countries to feed their own unsustainable consumption-led boom, the net proceeds in these countries had no developed domestic financial markets to invest in.

In response, these funds were channeled back to U.S. financial markets, and in the view of those who favor the savings glut theory, this set in motion the unsustainable boom. As time went on, the trade surpluses in Asia resulted in net capital outflows in search of a market to invest in. Western economies that were the recipients of these capital flows experienced remarkably low interest rates and credit booms with a corresponding buildup of debt.

Thus, in the view of proponents of the savings glut theory, the Federal Reserve was not the cause of lower interest rates, but rather it was a passive observer as interest rates were lowered exogenously by an influx of money from these foreign sources.

Asian Savings Explanation

Proponents of the global savings glut hypothesis must grapple with one unanswered question: What caused citizens of Asian countries to increase their savings rate and destabilize Western economies with their excess capital outflows?

One could take the view that savings rates are exogenously determined—e.g., by "animal spirits"—but this "explanation" pushes the problem only one step back. What determines these animal spirits?

To find a satisfying answer we must look at the role of monetary policy in determining saving rates.

There is no need to look to animal spirits or any ill-defined exogenous force to explain why developing countries increased their savings so much during the boom and funneled these savings into Western financial markets. The unsustainable boom propagated by Western central banks set this process in motion by creating a disconnect between the consumption demands and the domestic productive capacity of their economies.

With this insight, it becomes clear the loss of manufacturing in the United States is not the result of "greedy outsourcers" or even "currency manipulators" in Asian countries, despite the ire directed at both of these by savings glut believers.

The loss of productive capacity in the United States is the outcome of a too-low interest rate policy by the Federal Reserve incentivizing entrepreneurs to move their investments to the higher stages of production—those furthest from final consumption—while incentivizing consumers to increase their present consumption at the expense of savings.

David Howden **(dhowden@slu.edu)** *is chairman of the Department of Business and Economics, and associate professor of economics, at St. Louis University-Madrid.* *Used with permission of Mises.org.*

COMMENTARY

Twitter, Investors Gain from JOBS Act Regulatory Relief

By John Berlau

Almost two years ago, I wrote a *Wall Street Journal* op-ed titled, "Making It Legal to Tweet for Investors." In the op-ed, I described bipartisan bills that contained modest but significant deregulation of securities laws—an update for the age of social networking.

These bills were eventually merged into the Jumpstart Our Business Startups (JOBS) Act, signed by President Barack Obama in April 2012. And in a twist, Twitter used JOBS Act provisions for its own initial public offering, as revealed by the recent filing of its first IPO documents.

More Opportunity

Investors are better off for it, as companies like Twitter going public at earlier stages of growth will mean greater opportunity for ordinary shareholders to grow wealthy with the company. Going public at an earlier stage actually lessens the chance that an IPO will face a Facebook-type fiasco.

As I wrote just after Facebook's implosion last year, "the size of Facebook's IPO—over $100 billion in market capitalization—may have made it just 'too big to succeed' in generating a return for ordinary investors." Although Facebook stock is now finally a few dollars above its IPO price and may climb further, this won't change the problem that ordinary investors missed out on the spectacular growth in the company before it went public.

But a decade ago, even a $1 billion IPO—which LinkedIn, Groupon, and others have all exceeded in the past few years—was unheard of. In fact, Home Depot had only four stores when it went public in 1981. As the retail chain grew with the seed money from its small offering, so did the portfolio of its initial investors.

What changed was the sheer amount of regulation that burdens smaller public companies. Home Depot cofounder Bernie Marcus has said many times that his company never could have gone public when it was that small if provisions of the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Act of 2010 had been in effect back then.

The Securities and Exchange Commission has calculated that the average annual cost of one Sarbox provision alone—the mandates requiring extensive audits of a company's "internal controls"—comes to $2.3 million per public company and hits smaller public firms the hardest.

More Emerging Growth Companies

But the good news is that now because of the JOBS Act, companies launching an IPO are exempt from the internal control mandates and some other onerous provisions of Sarbox and Dodd-Frank until their fifth anniversary of going public, or until they reach $1 billion in annual revenues or $700 million in market valuation, whichever comes first.

In the 18 months since the JOBS Act went into effect, there has been a notable increase in small and midsize companies going public and designating themselves as "emerging growth companies" to take advantage of the exemptions under the law.

The online travel site Kayak and the discount retailer Five Below utilized the JOBS Act's five-year exemption in their IPOs that were widely regarded as successes. And we now know Twitter will be utilizing this JOBS Act provision, also called the "on-ramp," as well.

In the "Form S-1 " Twitter filed to launch its IPO, the company declares, "We are an emerging growth company, and … we may choose to take advantage of exemptions from various reporting requirements under the JOBS Act." Implying it will seek relief from the Sarbox internal control mandates, Twitter states, "Our independent registered public accounting firm is not required to audit the effectiveness of our internal control over financial reporting until after we are no longer an 'emerging growth company.'"

Because Twitter is such an established presence, it may surprise some that it's still a midsize company covered by the JOBS Act. But this is potentially good news for investors, as it shows Twitter still has room to grow and ordinary investors can get in on this growth.

> "[I]t may surprise some that [Twitter is] still a midsize company covered by the JOBS Act. But this is potentially good news for investors, as it shows Twitter still has room to grow and ordinary investors can get in on this growth."

Critics of the JOBS Act will say this modest regulatory relief for Twitter and other firms will lead to increased risk for investors. And indeed, there will be risks with Twitter as there is with every other public company.

Big Companies, Big Failures

Yet a year-and-a-half after the JOBS Act's "on-ramp" went into effect, there have been virtually no scandals involving "emerging growth companies." On the other hand, we are observing this fall the fifth anniversary of companies fully subject to Sarbanes-Oxley, such as Lehman Brothers and American International Group, imploding and taking the economy down with them.

For the JOBS Act to reach its true potential, it will of course have to be fully implemented. The Securities & Exchange Commission has inexcusably delayed implementing provisions such as the liberalization of equity crowdfunding, which would cut red tape to allow very small firms to raise small amounts of money from ordinary investors over the Internet. And we also need to get rid of burdensome and counterproductive rules from Sarbox and Dodd-Frank for all firms, so job growth and investor return aren't needlessly hampered.

But the JOBS Act's bringing about the return of small and midsize IPOs is definitely something to tweet about!

John Berlau is a senior fellow for finance and access to capital at the Competitive Enterprise Institute.

> "Home Depot had only four stores when it went public in 1981. As the retail chain grew with the seed money from its small offering, so did the portfolio of its initial investors."

U.S. Lends $35.6 Billion Through IMF Slush Fund

By Robert Romano

U.S. lending to foreign governments through the International Monetary Fund has reached $35.6 billion, representing more than 25 percent of the agency's $141.8 billion of outstanding loans. Well above its 17.7 percent quota, the U.S. is funding a disproportionate share of IMF loans.

Sixty-eight percent of IMF lending, or $96.9 billion, has gone to just three countries—Greece, Portugal, and Ireland—that have been rocked by sovereign and mortgage debt crises. The U.S. share of those European bailouts is now $24.35 billion. Should conditions worsen in Europe, we may ultimately wind up wishing we could get that money back from this foreign aid slush fund.

Initially, the IMF was set up by the West to issue foreign aid to Third World nations during the Cold War. It was never intended to bail out advanced economies, but now that is exactly what it is doing.

> "[The International Monetary Fund] was set up by the West to issue foreign aid to Third World nations during the Cold War. It was never intended to bail out advanced economies, but now that is exactly what it is doing."

Surge in U.S. Commitment

The U.S. stake in the IMF was just $57 billion a few years ago, but in 2009, the Pelosi-Reid Congress expanded contributions by $108 billion on top of that to a $165 billion total, including a $65 billion quota and a $100 billion line of credit. That is more than triple the first year of sequestration's $53 billion cut to outlays.

Participating countries have IMF funding quotas. In September the IMF reported a total quota of $360 billion, with $233 billion of loans committed. No more votes will occur now to approve further bailouts, as the agency can lend it all away if it desires.

The way Congress justifies these loans is by claiming minimal taxpayer liability. Almost none of this appears on-budget and is thus hidden from taxpayers, but like student loans, when the IMF draws from these lines of credit, it gets drawn directly from the Treasury by being added directly to the national debt.

Lousy Lending Record

The track record for government lending programs is far from perfect. Just consider Fannie Mae and Freddie Mac, which drew a $187.5 billion bailout when the mortgage bubble popped.

Or look at the Federal Housing Administration, which for the first time in its 79-year history has had to draw $1.7 billion from the U.S. Treasury to cover losses on bad loans.

Or Sallie Mae and the rest of the student loan program, where 10.9 percent of its $994 billion of loans are 90 days or more delinquent. In addition, half of all student loans are actually in grace periods, in deferment, or in forebearance, according to the New York Federal Reserve. Hence, for "loans in the repayment cycle delinquency rates are roughly twice as high."

Ideally, legislation in Congress would rescind the entire $165 billion IMF credit line. After all, why are we bailing out foreign countries that cannot even pay their own debts?

But, as noted above, the problem of government lending is not confined to any single agency.

Affront to Power Over Purse

Whether it's the Federal Reserve, Small Business Administration, the Export-Import Bank, the Dodd-Frank orderly liquidation fund, the Department of Energy's green loans, or Federal Deposit Insurance Corporation deposit guarantees—these institutions that provide unlimited financing to favored industries all take away Congress's constitutional power over the purse.

Largely, we are able to carry on these activities because of the dollar's reserve currency status—the nation's exorbitant privilege that keeps interest rates low even though all debts public and private are exceptionally high, at more than $57.5 trillion.

Pressure on Dollar

However, the United States cannot depend on this forever, as foreign creditors such as the Chinese are pressing to replace the dollar with another currency, namely its own.

The massive government lending problem may seem intractable—all these functions occur without any votes in Congress—but there is one simple step legislators can start with to begin to get it under control.

And that's to kill the IMF foreign aid slush fund.

Robert Romano is the senior editor of Americans for Limited Government. Used with permission of NetRightDaily.com.

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New York Retailers Win Credit Card Surcharge Case

By Natalie Rutledge

U.S. District Judge Jed Rakoff in October ruled in favor of a group of retailers who challenged New York's credit card surcharge law. The law subjects retailers to criminal penalties if they assess surcharges to customers who pay by credit card instead of cash.

Judge Jed Rakoff

Many retailers in New York assess a surcharge to offset the costs incurred with credit card processing fees. Most store owners have to pay approximately 3 percent of a transaction to their processing company. Retailers either raise their prices, create surcharges to offset these costs, or take less of a profit. The State of New York has been trying to stop these surcharges for some time, but Rakoff sided with the retailers.

Rakoff ruled the surcharge law violated the First Amendment by preventing store owners from alerting customers about the fees associated with their purchases. He wrote the law "perpetuates consumer confusion by preventing sellers from using the most effective means at their disposal to educate consumers about the true costs of credit-card usage."

According to the law, retailers can be subject to a $500 fine and up to one year in prison for imposing credit card surcharges. Rakoff has blocked the law until the case surrounding it is completed.

Natalie Rutledge (**natalie@lowcards.com**) *writes for LowCards.com, where this article first appeared. Used with permission.*

Young Borrowers More Responsible than Older Borrowers, Study Shows

By Natalie Rutledge

The common perception is that young adults are not financially responsible, mainly because they lack experience in dealing with money. But a recent study from Arizona State University suggests college-aged credit card users are actually more responsible than middle-aged borrowers.

The study showed cardholders between the ages of 18 and 25 are the least likely to default on their credit cards and the most likely to develop strong credit profiles in the future.

The study found "young borrowers are the least experienced financially and, conventionally, thought to be most prone to financial mistakes. Our results challenge the notion that young borrowers are bad borrowers."

Challenge to Credit CARD Act

This information challenges a portion of the Credit CARD Act of 2009, which prohibits applicants under the age of 21 from getting a credit card without a cosigner or proof of independent income. The study asserts, "We find no evidence that entry into the credit card market before age 21 increases the risk of financial problems later in individuals' twenties."

Furthermore, the study indicates there is a strong relationship between early credit card use and mortgage loans, meaning young borrowers are more likely to own a home at a young age. Many college-aged cardholders use credit cards to build their credit, so they may access homeownership in their early 20s. Delaying the use of credit cards may push those individuals further behind in their plans.

Natalie Rutledge (**natalie@lowcards.com**) *writes for LowCards.com. Used with permission.*

City of Nashville Must Pay Millions More for Convention Center Land

By Christopher Butler

The City of Nashville must make up for the $15 million in fair market value a private real estate development company says it lost when city officials used eminent domain laws to take the firm's land to build the Music City Convention Center.

The Tennessee Supreme Court declined to hear an appeal from the city's Metropolitan Development and Housing Agency. The MDHA had appealed a series of rulings that began when a Nashville jury in 2011 found the city had shortchanged Tower Investments for five-and-a-half acres of land downtown.

Millions More from Taxpayers

Taxpayers ultimately will pay millions of dollars more for the convention center than city officials promised. The city said the center would cost $500 million.

Tower Investments Vice President John Pierce said that by fighting to the end, which cost the company millions of dollars, Tower accomplished something many other landowners cannot afford to do.

"If you just have a parcel of land or a small business or a farm, and all of a sudden the government comes in and you are subject to condemnation, you are looking at putting out hundreds of thousands of dollars, if not millions, in legal costs that you will not be reimbursed for," Pierce said.

"Not a lot of people can do that. That is the saddest thing to me about it. I look at it from the standpoint that we are fighting for citizens' rights to get fair market value for their property, and a lot of people aren't able to make that fight."

Double Increase in Value

MDHA spokeswoman Holly McCall said the agency is prepared to move on.

"We still feel we had a strong case, given the amount Tower paid for the property and the 100 percent increase in value they asked for. But we respect the court's decision."

As reported in *Tennessee Watchdog*, Tower officials have always said the MDHA's original offer of $14.8 million was well below fair market value. They also said it wasn't enough compensation for the loss of land in what has become one of Nashville's most desirable areas.

The 2011 jury said fair market value for the land was $30.3 million.

Christopher Butler (**chris@tennesseewatchdog.org**) *reports for* Tennessee Watchdog, *where an earlier version of this article appeared. Used with permission of Watchdog.org.*

$20,000 Flood Premiums? If True, They're Signaling Big Risks

By R.J. Lehmann

Recent news reports on the roll-out of reforms to the National Flood Insurance Program have focused on astronomical increases in rates faced by some home and business owners. This language from an ABC News report has been fairly common:

"New flood maps threaten to saddle some homeowners who are paying a few hundred dollars a year now with annual premiums of more than $20,000."

There also have been anecdotal reports of premiums rising to $30,000, $45,000, even $60,000 a year. That's particularly shocking when you bear in mind that the NFIP offers only up to $250,000 of coverage.

How common are these sorts of increases, really? Unfortunately, the Federal Emergency Management Agency has not been terribly transparent about its rate map project, which the Biggert-Waters Flood Insurance Reform Act requires the agency to complete by next year.

Many of the NFIP's 5.6 million insured properties will see rate reductions under the updated, presumably more-accurate maps. Those that require rate increases will see them phased in over a five-year period.

Subsidies to Disappear

But the Biggert-Waters Act also calls for long-standing subsidized rates to be phased out over a four-year period for some of the 1.1 million NFIP policyholders who currently receive them.

The phase-out started in January for 345,000 second homes, while 87,000 business properties and 9,000 repetitive-loss properties saw their subsidies begin to be phased-out in October. The remaining 715,000 subsidized policies will revert to actuarial rates when the properties are resold.

Coverage of a recent hearing on the law further offers this nugget:

"Testifying at the same hearing, FEMA Administrator Craig Fugate defended the law, saying FEMA estimates subsidized policy holders should be paying $1.5 billion more than they do now. About 1.1 million of the 5.6 million policy holders pay subsidized rates, he said."

If ending subsidies on all the 1.1 million subsidized policies would raise an additional $1.5 billion annually, that comes out to about $1,363 per year, or $113 more per month. And that's an average. If there are some policies that really should be paying $25,000 a year, that means many more policies that would see increases of significantly less than the average.

Important Price Signals

This is not to minimize the impact of a $25,000 annual premium. Very few people could make those sorts of payments. But very few people are being asked to.

Indeed, what's important to bear in mind is that a $25,000 premium suggests a home that would suffer a complete loss roughly once every 10 years. If there exist policyholders who evaluate that risk-reward trade-off and find it compelling, more power to them. But it would be (and, indeed, it has been) remarkably unwise public policy to in any way subsidize such an arrangement and put that risk on the backs of taxpayers.

A $25,000 premium offers a price signal that one should strongly consider mitigating one's risk, or getting out of harm's way.

R.J. Lehmann is senior fellow, public affairs director, and co-founder of R Street Institute. Used with permission of RStreet.org.

Young Workers, Small Balances, and 'Extreme' IRA Allocations

Young workers with small balances and owners of Roth individual retirement accounts (IRAs) are more likely than other IRA owners to make "extreme" allocations to stocks or money, according to a new report from the nonpartisan Employee Benefit Research Institute.

The EBRI report, which defines "extreme" allocations as having less than 10 percent or more than 90 percent in a particular asset category in an account, found:

- By age, the youngest (younger than age 25) IRA owners had the highest percentage, with more than 90 percent in equities (37.5 percent). Above age 25, the percentage with more than 90 percent in money/cash equivalent funds decreased with age. However, the percentage of IRA owners above 25 with more than 90 percent invested in bonds and money combined decreased as the owner's age increased until age 75.
- By type, Roth and traditional IRAs established by contributions were more likely to have greater than 90 percent invested in equities and least likely to have more than 90 percent invested in money/cash equivalent funds. In contrast, traditional IRAs established by rollovers, and SEP/SIMPLE IRAs were much more likely to have 10 percent or less invested in equities and 90 percent or more invested in money/cash equivalent funds
- By account balance, IRA owners with higher account balances generally were less likely to have extreme asset allocations. For example, while 37.2 percent of those with account balances of $10,000–$24,999 had 90 percent or more of their assets invested in equities, only about 1 in 10 of those with account balances of $250,000 or more did.
- By gender, there was very little difference: About 29 percent of females and 28 percent of males had 90 percent or more of their IRA assets invested in equities. Similarly, 62 percent of females and about 65 percent of males had less than 10 percent invested in bonds.

The EBRI notes IRAs are a vital component of U.S. retirement savings, representing more than 25 percent of all retirement assets in the nation. A substantial portion of these IRA assets originated in other tax-qualified retirement plans, such as defined benefit (pension) and 401(k) plans, and were subsequently moved to IRAs through rollovers.

These and other findings from the latest update of the EBRI IRA Database, "IRA Asset Allocation, 2011," are published in the October *EBRI Notes*, online at www.ebri.org

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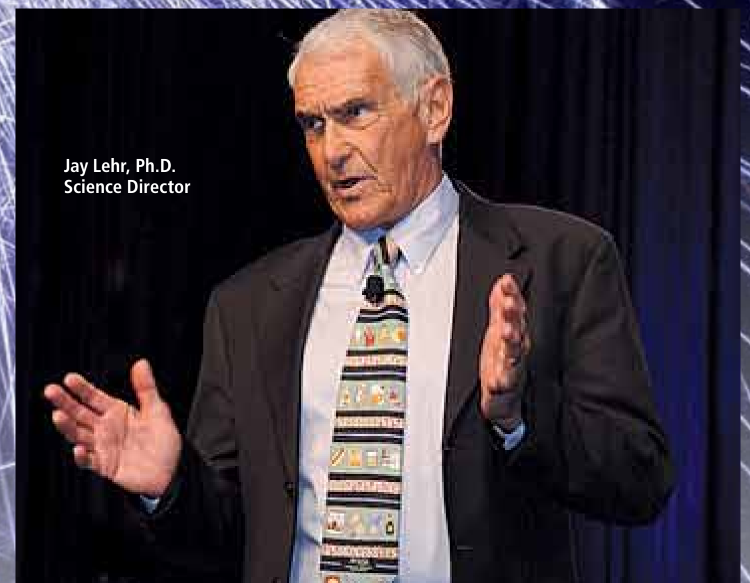
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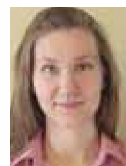

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