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Chasing our Tails in the Matter of Public Debt vs. Public Underinvestment

When I was very young and read the comic strips in the daily papers, it seems to me and my sieve-like memory that there was a grotesquely comic character – a bare-foot miserly primitive who saved his money by burying it in the backyard against a rainy day, while he let the roof of his shack go unrepaired so that water leaked into his bed whenever it rained.

He kept his kids at home from school to save the money that would have to be spent on the minimal clothes that the teacher insisted on their wearing to prevent indecent exposure. All in the interest of safeguarding their future, sedulously buried in that backyard hole.

Whether he actually existed in such extravagant detail, I cannot say, but he surges into my mind whenever I read the budget news from just about any capital.

Thus in *The Globe and Mail* (17/3/06) under a headline "US let's debt rise to almost $9-trillion" by Alan Freeman, you can read:

"Washington – It was just another day in the US Congress. By a vote of 52 by 48, the Senate voted yesterday to raise the limit on the federal debt by a cool $781 billion (US) – to a whopping total now nudging $9 trillion.

"That's trillion with a T, or about $30,000 for every man, woman, and child in the US, marking the fourth time that the so-called debt cap has been hiked since George W.

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Chasing *continued from page 1*

Bush became President in 2001."

"Like an overextended consumer who just got an increase in his credit-card limit, the US Treasury was quick to announce its intention to sell $37 billion worth of treasury bills that will go to pay for everything from the war in Iraq to Hurricane Katrina relief and health benefits for the elderly.

"All this from a Republican President working with a Republican-controlled Congress, who traditionally believe in small government and low taxes.

"The Republicans' addiction to debt leaves conservative economists and policy experts in despair.

"'I think that most observers have been shocked by how profligate the Republicans have been,' complained Stephen Slivinski, director of budget studies at the right-wing Cato Institute, a leading think tank in an interview."

"Treasury John Snow warned senators that if the borrowing limit wasn't raised, the US risked defaulting on its debt. Already, the government expects to spend $217 billion this year on interest payments, 2.5 times what Washington allocates for education.

"Mr. Slivinsky worries that this approach has turned the United States into a bastion of the fiscal free lunch where government spending goes up to pay for so-called entitlement programs such as Medicare or pork-barrel high-way projects while politicians insist nobody has to pay for them.

"Somebody needs to stand up and say, 'Stop me before I spend again,' said Pat Toomey, a former Republican member of Congress who now runs the conservative Club for Growth, a group that supports small-government candidates.

"When the budget cap was approved, a relieved Mr. Snow said the move assured the government 'can now deliver on promises already made, such as Social Security and Medicare payments and aid for the victims of the 2005 hurricanes.'"

But here we must pause and ask whether what is really at fault is not the twisted language we use to hide what is in the interest of a particular social group to hide. Going back to my memories of the primitive cartoon strip character in my daily newspaper, only one thing that would have to be changed so that the leak would be in other people's roofs, while he himself enjoyed a dry, soft bed, and a well-stocked table. And the language to produce this discrepancy between what really happens and the language distorted to cover up its real significance. Let's go back to our comic strip character:

It takes little thought to grasp that not repairing the roof in order to save for a rainy day, is nonsense. When you bury the money for that, the roof deteriorates further until more than just the roof has to be replaced – rotten and warped beams and siding. In short you are not only leaving the roof unrepaired, but guaranteeing further deterioration that will need far more capital investment to repair. And providing for the kids' future by saving the money for decent clothes that would allow them to attend school is guaranteeing that they will grow up with the dreadful disadvantage of illiterates in an economy that requires more than secondary education to stand a chance at earning a half-decent living. Today most fairly paid employment – indeed most jobs in general – require computer illiteracy and a college education. Unless every child with the talent to profit by such an education is able to receive it, the nation as a whole will suffer.

The Suppressed Discovery of Theodore Schultz

Over forty years ago an American academic, Theodore Schultz, received a Nobel Prize for Economics for having concluded from the rapid recovery of Germany and Japan from their WWII destruction, that investment in human capital – i.e., education is the most productive investment that a nation can make. He had been one of a hundred young economists sent to those two major defeated countries at the end of WWII to predict how long it would take for them to become serious competitors of the US on world markets once more. Twenty years later, he asked himself how he and his colleagues could have been so wide of the mark in their forecasts. He concluded that it was because they had concentrated on the physical destruction, but ignored the human capital – the disciplined, highly educated population of Germany and Japan that had come through the war largely intact. From that his conclusion was: human capital was the most productive investment a nation could make. From there not only education, but health belongs to that category, since it protects the vessel in which the skills and educations are kept. Not only are education and health capital, but capital with the slowest rate of depreciation – the children of educated parents are not only better educated and healthier, but are likely to pass on such advantages to their own offspring.

Ignoring such crucial social investments – even after they had been discovered – to keep the net return on speculative financial profits sky-high is at the source of most of our present society's ills. The cartoon character of my youth not only keeps his kids home from school, to save spending on the necessary clothes supposedly to assure their future, but he doesn't provide proper medical care, to assure that future even if it might mean an early death for them. Such are the incredible conclusions you reach if you concentrate your attention on the hole in the ground where all of society's supposed "savings" go.

"Jim Horney, a senior fellow at the left-leaning Center on the Budget and Policy Priorities, said things were going just fine under Bill Clinton, who ran up four years of budget surpluses before Mr. Bush decided to slash taxes, especially on the wealthy."

The Real Secret of Clinton's Black Magic

But the real secret of Clinton's black magic in creating a budgetary surplus where previously a growing deficit had been reported remains a locked-up secret with the key thrown away.

In 1994 the Bank for International Settlements – a semi-secret organization of central bankers that does not even tolerate representatives of governments at its meetings – created the greatest booboo in the history of central banking and missed by inches bringing the entire monetary system of the world down in one global crash. As a result of the world-wide deregulation of the banks that had allowed them to take over the other "financial pillars" – stock market brokerages, insurance and mortgage companies. Within a decade the banks had lost most or all their capital in highly leveraged speculation. BIS to bail them out had brought in its Risk-Based Capital Requirements that declared the debt of central governments of developed countries "risk-free," needing no additional capital for banks to acquire. As a result Canadian banks quadrupled their holdings of government debt to some $80 billion. A few years later, 1991, the statutory reserves – which banks had to put up with the central bank as a percentage of the stock it received on deposit from the public on a non-interest-earning basis – were abolished. Increasing those reserves when the economy seemed over-heated provided an alternative to raising interest rates for fighting perceived "inflation." Now high interest rates were left as the lone tool for that purpose. And BIS chose that moment to start a campaign to attain "zero inflation" by whatever increase in its benchmark interest rate might be needed. What it overlooked, was that as interest rates were pushed towards the heavens the government bond hoards accumulated by the banks to replace their lost capital would shrivel in value, and drive the banks into bankruptcy once more.

Clinton's Secretary of the Treasury Saves the Day in Midnight Darkness

And here. Robert Rubin, Clinton's Secretary of the Treasury, a canny alumnus of Wall Street devised the pro tem solution that allowed Clinton to retain the political center while retreating from the high interest insanity at the very time that the BIS had made it possible for the insolvent banking systems to tap into the government treasury with their 100% leveraged hoards of government bonds. For decades a tiny minority of accountants and economists had targeted the swindle of government accountancy that made no distinction between a current expense such as floor wax – completely used up in the year of its purchase – and say a bridge that would last for generations. Under the prevailing "current accounting" both were written off in the year of their acquisition and subsequently would be carried on the government books at a token dollar. This served the ideological end of proclaiming the government incapable of making investments, and capable only of wasting money. Also, by showing government in permanent and increasing indebtedness, it promoted the privatization of valuable government investments at a tiny fraction of their real value, and provided a steady flow of basement bargains to well-connected entrepreneurs. Clinton was not prepared to openly challenge this fraud. But he stepped in to prevent the incipient monetary collapse that the utterly incompetent BIS had precipitated. This he did by introducing accrual accountancy surreptitiously under another name. In the 1996 January statistics of the Department of Commerce, the assets of the federal government are shown increased by $1.3 trillion. Accrual accountancy had been applied not only to the current year but taken back several years). This, however, appeared under the heading of "Savings," which it certainly was not since that word to economists implied uninvested cash or near-cash, and the rediscovered assets were investments in the form of buildings, bridges, roads, equipment. But a wink and nod to the bond rating agencies sufficed – that sort of camouflage had been applied for years.

It brought in a regime of lower interest rates, that in time revived the stock market, gave Clinton a second term, and led to the boom and bust climaxing in 2000.

Yet by hiding the true nature of the change the broad public had been swindled once again. The period of privatization by which public assets were sold for a song entered its period of glory. Deregulation led to the period of two-tier economies, in which the real production was largely deflated by outsourcing of increasing amounts of production to China and other Third World countries, while the financial sector was inflated through the use of derivatives with price effects that had little to do with the markets of real products. Increasingly deficits are directed to military ends particularly as Washington finds its role as lone superpower challenged by China, and other aspirants to superpower status.

A Period of Low Interest Bonanza Brought Us by a BIS Blunder

There is, too, the extension of accrual accountancy which has begun to be brought into the books of the Canadian government only due to the insistence of the previous Auditor General, undoubtedly encouraged by its secret adoption in the United States. The many-week-long argument of the then Finance Minister Paul Martin with the Auditor-General, raises an ethical question that has in fact sent many an executive in the US to jail – pressuring their auditors to "cook the books" – a term used by the Canadian Auditor-General Denis Desautels during his weeks of argument with Mr. Martin.

To get society off this conveyor belt to disaster, we have need of the lessons that had been learned in the 1930s and the subsequent three decades. Only a complete review of suppressed economic doctrines can prevent society from repeating the disastrous errors of the past. Instead what we got was an even deeper interment of our history.

Without complete information about the economy, Parliament cannot honour the Magna Charta that gave it control of the taxation of government. Not only must accrual accountancy be introduced openly and the members and the public explained its significance, but it must be applied not only to physical investments of government, but to investments in human capital. Unless this is done our democracy will continue wasting on the vine.

William Krehm

A Two-track Economic System

The following is a condensed version of an article sent to us by Shirley Farlinger "A Two Track Economic System," and our comments in italics. We inserted these not because we considered that Ms. Farlinger's article needed correcting, but because we felt she had reached the very doorstep of a most important conclusion: it is impossible to group under the one heading of "inflation" two very distinct key phenomena: a rising price level due to an excess of market demand over market supply – something that I have called "market inflation"; and higher prices that reflect a necessarily growing public sector in our mixed economy whose output is not marketed but paid for by taxation. This very distinct category of price rise, I have termed "structural price rise." Rather than something to be repressed with higher interest rates, this must be respected. For it provides infrastructures essential to society and hence to the private sector itself.

The economy of any country runs on two tracks and I believe it is helpful in understanding how our economy works to separate the two. Track one is the public track and track two the private. The public track is all the things supplied and supported by public money, namely taxes, and the private all that is supplied and supported by private money. The policies that work well on one track do not work on the other, and the objectives of one are different from those of the other. Yet we persist in trying to apply the same rules to both.

When an entrepreneur wishes to establish a private company, a prospectus is written and enough shareholders are sought to raise the capital needed to start the business. The shares can be traded on the stock market. The process of capitalization also depends on the availability of capital, the current interest rates, the value of the currency, and the rate of inflation, all factors which are closely connected. The current stock market is no more than a gambling table as billions of dollars are churned around the world at electronic speed. Only a small fraction of this money is related to actual production.

For public works the money needed comes from taxes or must be borrowed. These works include libraries, schools, hospitals, roads, policy, etc. In the case of the Darlington nuclear station the cost of borrowing contributed to tripling the original estimate.

The government has a few methods of affecting the economy: job creation, interest rates, tax policies and grants or other concessions to certain sectors. It has become common practice to raise interest rates to curb "inflation." But there are many better ways of dealing with "inflation" than raising interest rates.

[A higher price level may be due to very different causes. It could be due to an excess of demand over available supply, This we could term "market inflation." Or it could result from an increase in taxes proportionately higher than the growth of the tax base, i.e., the private sector. Just as we identify the children of parents through the use of distinct surnames, should we not do something similar to distinguish the very different possible causes of a given increase in the price level? For example we might call such rises of the price level "structural price increases." Doesn't Shirley's fine analysis seem to be striving to a distinction in nomenclature that will help end the current confusion between the two types of rise in our price indexes?]

The policy priorities at present at federal and provincial levels seem to be "open for business," to keep inflation low, even if this increases unemployment, adjusting interest rates and cutting taxes. The supposed benefits of these priorities are a stimulation of foreign investment, an increase in exports and more concessions for business leading to more jobs and less poverty. Originally described as the "trickle-down effect," this ideology affects every decision made by our politicians. It has become the rationale in all ministries.

The Perils of Globalization

Globalization with its financial policies trying to equate foreign investment with prosperity follows the policies of the World Bank and the International Monetary Fund. This is making it difficult for nations to protect their assets and invest in new ones. Jobs are created, but they are poorly paid, easily transferred to other countries or made redundant through technology Only people with decent jobs can afford good health and education. Good jobs can lift people out of poverty and therefore enable them to purchase the goods that businesses want to sell. Even public-private partnerships do not help because too many tax-dollars end up in shareholder profits.

It is clear one policy cannot fit both the public and the private economies. Every country must have the right to develop its own public assets and institutions. Then the private sector can operate in a milieu of cooperation with healthy, educated workers and a preserved resource base. The recent rejection by Mexico of the OECD's suggestion of a corporate code of conduct for global trade is symptomatic of the problem of globalization. Mexico rightly observes that it will lose out on jobs if the standards are raised for workers. Cheap labour and the right to damage the environment are Mexico's big advantages. Until we sort out what countries can be allowed to do to benefit their own public sector and how this can be maintained in cooperation with the private sector, we will continue on our rat race to the bottom.

Many will say that it would be impossible to keep the two tracks, the public and the private, separate. That would entail national non-convertible currencies, national banks with charters that enable local public economies to flourish. Thailand has recognized the trap that the IMF and the World Bank's structural adjustment policies have set for indebted countries. Thailand has paid off its debt, and will not borrow there again. The debt trap has been an instrument of US foreign policy enabling the US to dictate the fiscal policies of other countries for the benefit of US transnational corporations. If your country is not "creditworthy" by IMF standards, you will not be able to borrow from any financial institution. Putting a financial firewall between local and international fiscal policies may require local non-convertible currencies, a limit on capital outflows, attention to local needs and expertise (not just a cry to eliminate poverty).

An attack on neo-con globalization will not mean a retreat into isolation. In fact, a greater appreciation of the needs of people around the world would have stopped globalization long ago much the same way as the MAI. By not separating the public economy from the private economy, it has been impossible for our decision-makers to design policies that would work for the benefit of most citizens in the public sphere.

In the public economy high interest rates have increased government debt to dangerous levels. Cheap money should be made available for government expenditures as the *Bank of Canada Act* envisaged. The Bank of Canada is wholly owned by the government of Canada and its capital should be available

to the Canadian people. When the Bank of Canada Governor raises interest rates, hundreds of businesses can be forced into bankruptcy, thousands of homeowners can be put out of their homes, and thousands of workers out of their jobs. Yet the mandate defined in the *Bank of Canada Act* is "generally to promote the economic and financial welfare of Canada."

High interest rates benefit those with money and so are suitable for those with fixed assets who do not need to borrow. Low interest rates help small businesses, mortgage mortgagors, and those needing to borrow. Low interest rates create more jobs. The public economy benefits from a high rate of employment as people pay income taxes and need less social assistance. When employment is low, bosses have to compete for workers and the power of employers to dictate labour conditions is mitigated.

The private economy likes a steady rate of unemployment because that helps control labour, reduces labour's ability to strike and enables companies to lower health and environmental standards and employment equity rights, and generally creates a climate of uncertainty. To give this policy a better image, economists have invented the NAIRU, the non-accelerating inflation rate of unemployment and contend that seven percent is really equal to full employment.

The Unreasonable Use of High Interest Rates as a Stabilizer

The connection the government makes between interest rates and inflation is not reasonable. "Trying to strangle inflation with high interest rates sends a multiplier shock back to the price index, unleashing a vicious circle that chokes off growth, jobs, and the consumer spending on which many economists rely – another vicious circle" (*Building a "Win-Win World,"* Hazel Henderson, p. 98).

There are many causes of "inflation" and high interest rates can be one cause. But raising interest rates puts the economy in danger of recession. Of course, people with money do not want to see their spending power reduced by higher prices. Higher prices, however, help all borrowers including the government.

Foreign investment is another misguided federal priority. When our banks promote the acquisition and merger of our small businesses, we lose out on jobs, research, skill development, national interests and the industries we need to be self-sufficient. When this policy is extended to buying up our public economy through privatization, we see the erosion of public services and the draining of our tax dollars into the private sector. Without public money, our hospitals, roads, libraries, arts and infrastructures suffer. Without public money, such amenities can never be provided.

The public economy is a regulated one because the citizens want to preserve the environment, to operate within the laws of the courts and parliament and to abide by the United Nations agreements forged over many years.

The private economy sees regulations as a constraint of trade, a drag on business and as unnecessary red tape.

One of the big differences between the public and private sectors is the question of bankruptcy. A country cannot go bankrupt because there are always future tax revenues and resources. A business can easily go bankrupt, rid itself of a debt burden, recapitalize and start up again with a fresh slate. However, it seems that the business powers like countries to be heavily in debt. That way they can wring concessions out of governments and lower the amount companies have to pay in taxes or in a slice of the profits for the government.

When a national economy depends on foreign investment and that investment quickly leaves, as in the Argentine, the country's unemployment rate rises, the value of the currency plummets, factories are abandoned and governments topple. Yet the technology, the skilled workforce even sufficient capital are still within the country.

The globalization idea of the future should include a bottom line policy of preserving or rehabilitating the environment. For example, Norway's decision to set up a huge (two million) seed repository to preserve the genetic building blocks of edible plants is part of the United National Food and Agriculture Organization's plan to establish seed repositories around the world. There is the globalization of good ideas often carried out by the volunteers, e.g., China's Green Wall to halt growing deserts, part of the UN's Plan of Action to Combat Desertification in 2006.

The present policies of deregulation, interest and monetary manipulation, inflation-bogeyman thinking, privatization and tax reductions are destroying our lives, our ecosystems and making billions of people poor and desperate. The reaction is global and growing.

Shirley Farlinger

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Deregulation Challenged in European Union: Kalamazoo Philanthropists Find Solution Where Economists Failed

In 1993 a Nobel Prize for Economics was awarded to Douglass North for tracking down the relationship between a basic redistribution of the national income and the break-up of the political alliances responsible for it. This illuminates in a flash the falling apart of our Progressive-Conservative Party after the bail-out and further deregulation of our banks under Mulroney. Or the current falling apart of the Liberal Party, and the general mania for political leaders crossing over to the other side in Parliament, as though the game had become one of musical chairs. Douglass North's insight may be complemented by tracking down the particular economic dogma that had to be enthroned to effect such a redistribution of the national income, with its devastating effects on the political system.

There has rarely been a lack of economic theories for politicians to choose from in a reasonably free university system. But it is only when one of these is recognized as really useful to a significant group aspiring to power that it takes on some of the features of a militant theocracy. If it stops short of burning dissidents at the stake, it forces early retirement from their teaching positions of those who challenge the new orthodoxy.

Balanced but Falsified Budgets Make Privatization Mandatory

In this way the ideas of economists as significant as John Maynard Keynes, have been removed from our educational curricula. And thus the dearly-bought lessons of history have been hidden from the new generation of economists. That process is a necessary prelude to the drastic redistribution of the national income that Douglass North found to be decisive in changing political systems.

A single instance of this recurrent phenomenon will illustrate the point. Today the world is in the throes of an energy shortage, resulting from the deregulation of world trade. The huge jump in the world's need of gas and oil have brought on wars and terrorism between Islam and the West. It is contributing to the warming of our planet and the certainty of further environmental disasters. But all this might been avoided, if a seemingly innocent remark of Keynes had been pondered: "Denmark," he said, "sends us their cookies and we send them ours. Wouldn't it be better if we exchanged recipes?" Behind that simple question, lies a devastating criticism of the present compulsion to grow the Gross Domestic Product and foreign trade which threatens to do in our civilization and the planet itself.

One of the key provisions of the *Bank Act* brought in under Roosevelt to fight our way out of the Depression of the 1930s was the ban on banks becoming involved in the other "financial pillars" – stock markets, insurance, and real estate mortgages. In the 1970s and 1980s and ever since, however, banks have been allowed and even encouraged to acquire these other "financial pillars," and use their reserves needed for their own operations for speculative money creation.

Deregulation and growth have been identified as the ultimate purpose of the economy and even, it would seem, of human existence itself. World free trade and even union in economic blocks further that end.

However, the European Union – once regarded as Europe's initiative to end wars – has carefully carried forward just about every economic compulsion that has led to the major wars of the past.

Thus the member nations are required by the European Central Bank not to exceed a 3% budgetary deficit, calculated by making no distinction between capital investments by the national governments, and their current expenditures. In societies of aging populations, with an increasing dependency on immigration from Asia and Africa, this in itself condemns the continent to ever deepening conflict between the privileged classes and the immigrants, that have need of special social infrastructures to attain the living standards of the native population. Today, however, even native workers in countries such as France, Spain, and Italy on entering the work force are denied the safeguards for their employment enjoyed by older workers. Little wonder then the heaving unrest throughout much of the continent. To balance such budgets, of course, the obvious solution is to go on privatization binges of government assets. Since they appear on government books, if at all, at a token one euro – it is easy to foretell what wild bargains are to be had by the well-connected.

Italy, with its rich background in comic opera, has carried this to its greatest heights. The Italian economy is among the worst performers of the 12 members of the EU – largely because of the murderous competition of cheap Chinese imports that have displaced domestic specialty consumer goods. The current head of government, Silvio Berlusconi, an internet tycoon who is reported to have increased his wealth considerably during his terms in office, has opted to correct the situation by slashing taxes and replacing the loss to the treasury by privatizing not only the usual highways, power companies, and other such infrastructures, but by leasing Italy's priceless historical monuments to private entrepreneurs who would "operate" them for user fees. A special "forgiveness" law (*Condoni)* has been passed that for modest payments "forgives" such sins as evasion of taxes, or the development of real estate sites for which the developer has no legal claim. The result: only Greece with 28.7% of its economy underground surpasses Italy (during 2002-3) with 25.7%. Corresponding figures were 16.8% for Germany and 14.5% for France. In an editorial of *Il Corriere della Sera* (25/9/1991) has written: "In South America, fiscal forgiveness is granted after a political coup. In Italy it takes place before elections. But the end result is the same: it is a privilege outside the laws of the land. The hole left in the budget can be dealt with by leasing out the endless antique treasures of the land (Guido Borghetti: Il Libro Nero del Governo Berlusconi).

Protectionism Revives

Mr. Berlusconi is an enthusiastic supporter of President George Bush and his foreign policies – a feature that received great prominence in the current election campaign.

Most remarkable is that the European Union rather than appeasing national ri-

valries seems, if anything to be sharpening them. This came to a head recently when in the words of the *International Herald Tribune* (14/3/06): "European barriers: point, counterpoint. As more firms challenge regulators, some see dire future for single market" by Mark Landler and Paul Meller: "'Europe's biggest economies are particularly susceptible to protectionism these days,' said Charlie McCreevy, the European commissioner because of the markets' debilitating combination of sluggish growth, high unemployment, and the grinding fear of losing jobs to lower-wage countries in Eastern Europe and Asia.

"Last year's rejection of the European Union constitution by voters in France and the Netherlands has made it easier for politicians to promote national interest over European ideals.

"Yet for all that, he noted that the number of cross-border deals in Europe so far this year is at the highest level since 2000. And the deal-making is spreading into industries like electricity and power which used to be the sole preserve of national governments. Although many of these industries are privatized, they remain jealously guarded by regulators. Spain is scrambling to prevent a takeover of publicly traded Endesa by the German power giant EON. The French government orchestrated a snap merger of two utilities, publicly traded Suez and state-controlled Gaz de France, to fight off a potential takeover bid by Enel of Italy.

"The Villepin government in France has been asked by Brussels to account for its actions after rumors surfaced that Enel, the Italian utility was preparing a bid for Suez.

"Also under scrutiny is a new French law that puts several industries off limits to foreign takeovers. The legislation was drafted after Pepsico expressed interest in buying the yogurt giant, Danone.

"'Suez-Gaz could end up being owned by hedge funds,' said Daniel Gros, director of the Center for European Policy Studies in Brussels.

"Brussels is closer to filing a case against Poland for demanding that an Italian Bank, Unicredit, divest the Polish holdings of its recently acquired subsidiary, HVB Group of Germany."

It is inevitable that a political union such as the EU founded on the assumptions of a deregulated market and blind to social requirements should end up in less than the promised harmony. For the deregulated market works under the constraint that the value of the securities marketed at home and abroad will continue growing at the rates already incorporated into their market price. That calls for an unrelenting struggle for growth at all levels. But the very price pressures not only from Asiatic countries, but from the underdeveloped parts of some of the lands about to enter the EU rule that out – given the budgetary constraints imposed by the ECB and the ceiling on the national governments spending under which no distinction is made between social investment by governments and expenditure for current ends. Ideological blinders hide the distinction.

Light from Kalamazoo

Even philanthropists, without any particular expertise in economics good or bad, have on occasion arrived at favourable solutions of such problems. *The Wall Street Journal* (10/03, "Kalamazoo, Mich., Pegs Revitalization on a Tuition Plan" by Neal E Boudette) tells a most amazing tale.

"Kalamazoo, Mich. – Last year, Greg DeHaan and his partner built 189 homes in the leafy, middle-class suburbs ringing this downtrodden city, but not one in Kalamazoo itself 'There was no demand,' says Mr. DeHaan, whose company, Allen Edwin Homes, is one of the largest home builders in Michigan.

"By early December, however, a market had suddenly materialized, prompting the developers to pay $7 million for three separate tracts of land. Out-of-state investors began scouring the area for opportunities, too.

"Mr. DeHaan and others in town attribute this new interest in Kalamazoo to an unusual, anonymously funded plan. Beginning this June, college tuition will be free for any student who enters the Kalamazoo school system by the 9th grade – regardless of income or need. The program, unveiled in November by the city's superintendent of schools and underwritten by a group of local, unnamed philanthropists, is to run for at least 13 years."

Kalamazoo's "Promise"

"Called 'The Kalamazoo Promise,' the plan requires only that students live in Kalamazoo or neighboring Oshtemo township, graduate from public high school and attend a public university college in Michigan. Students who go from kindergarten through the twelfth grade get a full ride. The program will cover 65% of tuition costs for those who spend at least their four years in the city schools, with the percentage of aid rising for whose who spend more years in the system.

"With its commitment to the Promise, Kalamazoo is upsetting the traditional economic development model. In the past blighted cities across the nation signed onto various types of renewal plans. Mainly, they focussed on physical improvements – including new public spaces, office parks and other civic amenities – in hope of spurring economic and social progress.

"The Promise is different. By making education the cornerstone of the city's turnaround plan, Kalamazoo is hoping that other positive changes will follow.

"Mr. DeHaan, the developer, says the Promise has already helped fuel housing demand. Both families and investors from outside are hunting for property, which has seen modest price increases.

"What isn't clear is whether the Promise will bring much-needed jobs to Kalamazoo, a regional development agency says the number of inquiries from small businesses has recently quadrupled to between 20 and 25 calls a week.

"John Austin, a nonresident fellow at the Brookings Institution, suspects the Promise will have a big economic punch in the long run. 'The places that produce and attract talented people are going to be at the center of today's economy,' he says. 'Your economic future is linked to how many people get a post-secondary higher education and how many you can keep within the community.'

"Kalamazoo's population of 77,000 is roughly 70% white and has a mix of blue-collar and middle-class neighborhoods. Waves of plant closings, including Upjohn Co. and General Motors Corp., have left the once-affluent city with a depleted center and a poverty rate of 25%. 'We gathered together all the stakeholders and looked at the overall health of the county,' says Mr. Johnson. Many in K. speculate that Mr. Johnson and his wife are among the donors. [He says only that 'the donors have requested anonymity.'] His wife is Ronda Stryker, who has a net worth of $2.2 billion, according to *Forbes* magazine.

"A few years ago, a group of wealthy individuals began discussing the same issues, and invited Janice Brown, superintendent of schools, to join them. Over time, the group focused its talks on the links between jobs and education.

"Eventually,' recalls Dr. Brown, 'one of the group's members posed a question: What if everybody got a college education?' Mr. Johnson says.

"The idea seemed to strike at the heart of a problem facing cities in the Midwest. In the past, all around the Great Lakes, a high-school diploma was all that was needed to get a factory job paying good, middle-class wages. Over the past two decades, the Midwest has struggled to shift away from manufacturing to what is often called the 'knowledge-based economy' – newer, advanced industries and professions that require more education.

"Forty years ago, Kalamazoo was a rarity among industrial cities of the Middlewest. It was home to plenty of gritty factories, like the half dozen or so paper plants along the Kalamazoo River and the Checker Motors Corp. that made taxi-cabs. A General Motors stamping plant employed more than 3,000 General Motors union workers."

"Education Equals Economics"

"But the city also had an artsy, affluent side. Downtown features an elaborate, European-style pedestrian mall with fountains and tall evergreens. In the hilly neighborhoods southwest of the city's center, well-paid scientists and researchers lived in stately homes. A city symphony, a lively arts community and the city's schools flourished, thanks in part to backing from wealth families such as the Upjohns and Strykers.

"Today Kalamazoo looks more like other cities across the Rust Belt.

"The donors think the Promise 'is the way to revitalize their city,' says Dr. Brown, one of the few people in the city who knows their identities. They believe that 'equal access to higher education for all' creates a powerful incentive that will bring people and employers back to Kalamazoo.

"By last September, the group had a plan in place. Unlike other free-tuition programs, which often limit eligibility, the Promise was designed to serve as many students as possible, with no grade-point requirements. All Kalamazoo residents who graduate from high school and are accepted at public Michigan colleges will qualify – including students applying to community colleges.

"The public got its first word of the Promise on Nov. 10, when parents, students and local reporters were urged to attend a school-board meeting. Dr. Brown took the microphone, saying, a 'group of donors who understand that education equals economics are making an investment in our students.' The crowd gasped, then began clapping. Parents and board members wiped away tears.

"The Promise will cover tuition costs – which range from about $1,700 a year for community college to almost $9,000 a year at the University of Michigan – but not room and board. Bills are to be paid by the donors, with no money going directly to students or their families.

"Just before Valentine's Day, a new sign of the Promise's allure emerged: Enrollment in the city's schools has been declining for years. But on this kindergarten orientation day, 277 youngsters were registered to start school in September – up from 193 last year."

William Krehm

On the Cost to Society of the Memory Loss Imposed on It by BIS

In previous issues of *ER* we have retold several times the sequence of events that led to the abandonment of ever higher interest rates as a way of what is called "fighting inflation." We have repeated the tale so often, because those who should have recounted it a single time systematically failed to do so. And yet it was a very crucial bit of history, that explains not only how two incompatible policies dictated by the Bank of International Settlements, an unelected body of central bankers almost brought the world monetary system crashing. BIS which was slated at the Bretton Woods Conference of 1944 by its Resolution 5, to be liquidated at the earliest possible moment, nonetheless survived and organized the bailout of the world banks from the loss of much of their capital in speculative activities incompatible with banking. There were two important steps sponsored by BIS for this purpose: (1) By the BIS-sponsored Guidelines for Risk-Based Capital Requirements issued in 1988, the debt of developed countries was declared "risk-free," thus requiring no down-payment for banks to acquire. (2) The manager of BIS at the time, Alexandre Lamfalussy, proclaimed the need to bring the "inflation rate" down to absolute zero – in the one way that BIS recognizes as the means for doing so – raising interest rates.

What BIS and the central bank who blindly followed its views overlooked, was that rescuing the banks from their speculative losses by allowing them to load up with government debt with no down payment is incompatible with pushing up interest rates until price indexes lie flat. For when interest rate move higher, pre-existing government bonds will drop in market value, reflecting the fact that new government bonds will be issued at par with a higher coupon. It is incredible that a non-government institution that takes it upon itself to dictate to the central banks of the world their course to follow should have overlooked so simple a relationship. But then its attention was obviously preempted by other concerns.

As a result of this oversight, not only did the Mexican peso collapse, but currencies throughout the world were seriously threatened to do likewise. The situation was saved in the short term by the initiative of President Clinton – without the backing of Congress – putting together a $51 billion standby-fund to meet the emergency. More important, his Secretary of the Treasury, Robert Rubin grasped the incompatibility of higher interest rates intended as a "stabilizer" with the huge bond hoards that banks had accumulated since 1988 of which they were able to clip the coupons to replace their lost capital. Since terminating that feature of the bank bailout was not considered practical in governmental circles, Rubin resorted to another measure that for decades had not even been mentioned in polite governmental and academic circles – he brought in accrual accountancy into the books of the US government.

Cooking the Government Books with Explosive Fuel

Up to that point the acquisition by the government of a building, the construction of a road or a highway, or any other physical capital item that would last for decades, was treated exactly as floor-wax purchases – it was written off as completely consumed in the first year of its existence, and thereafter recorded on the government books at a token single dollar. Clearly this wildly exaggerated the government debt and understated net worth. It also made possible countless sweetheart privatization deals to sell a capital item at say 1,000 or 100,000 its value on the government's books, and apply the "profit" to "pay down the government debt." Reorganized and listed on the stock market such assets enriched many a government supporter. Then, of course, the taxpayers began paying a second time in "user fees" what they had already paid for in taxes.

Thus far the story that we have many times told. What is new is the punch-line of our tale that happened on March 28, when the new chairman of the US Federal Reserve, Mr. Ben Bernanke, could think of nothing better than to add a 15th quarterly increase of 1/4% to the 14 successive ones already brought in by his predecessor, Alan Greenspan. *The Wall Street Journal* (29/03) summed up the reaction:

"Especially disturbing for investors was the sight of bond prices heading sharply upwards, pushing the yield of the bellwether 10-year Treasury note to 4.788%, the highest level since June 2044. Higher yields for longer-term bonds presented consumers and many businesses with a double whammy, because the Fed at the same time pushed up short-term interest rates by another quarter percentage point. Market interest rates such as bank rates, credit-card rates and mortgage rates to tend to be based either on Treasury yields or on the Fed's target rates."

That leaves Mr. Bernanke indebted to the American public (as our Bank of Canada Governor Mr. Dodge – should he follow Mr. Bernanke's lead – to Canadians) for several explanations:

1. Where does he think that leaves the banks that they oversee? Neither gentleman could be unaware that to bail out the banks from the losses resulting from their deregulation, the Bank for International Settlements Risk-Based Capital Requirements was rushed through so fast, that the central banks and the BIS overlooked that the allegedly risk-free government bonds they were allowed to load up with without putting up a penny of their own, would drop in value if ever they resumed carrying out the BIS nonsense of bringing down what it chose to call "inflation" to absolute zero. Repeatedly, the manager of BIS, Alexandre Lamfalussy had declared that nothing more than zero would do. It was obvious to COMER and a few others that if that were allowed to happen the banks would be in for yet another close bout with bankruptcy. President Bill Clinton, appraised of the havoc it had already created in Mexico, the US and Canada's partner in the newly promoted NAFTA, did not even stop to get his Congress on board. With the help of the IMF and the Government of Canada, he rushed through the largest standby fund up to then arranged to prevent of the world financial system from going belly up – $51 billion US. That didn't come soon enough to rescue the Mexican banks that were renationalized, and replaced by a new stock market group for marketing Mexican government debt. But it contributed to postpone and soften the echo effects in East Asia and in bringing on the default of default of the Russian debt.

It had another result that would have been far more positive, had it been done openly and explained to the public of the US and the world. Clinton's Secretary of the Treasury, Robert Rubin, a bright alumnus of Wall Street came up with a way out of this nightmare. The "debt" of the US government as that of most governments throughout the world, had been unconscionably exaggerated by treating the government investments in physical capital – roads, bridges, buildings, equipment, exactly as the purchases of floor wax for the government washrooms – as a current expenses, reduced at best to a token value of $1 starting with year two of its acquisition, even though the asset might last for a half century. But that was an ideological fortress thrown up to support the contention of the groups in power that governments are simply incapable of investing. They just know how to waste money – even though they bail out the banks at fairly regular intervals rather than vice versa. One of Clinton's few principles was that he had to hold on to the "political center," and to meet that criterion, not a word of explanation was offered on how the government miraculously found another 1.3 trillion dollars of assets merely by recognizing the depreciated value of its physical assets and carrying the process back some years. Instead it showed up in an item in the Department of Commerce's statistics as "savings." But "savings" implies cash, and these neglected assets were of such illiquid things as steel, bricks and concrete. Had Clinton been open about what he was doing, the public of the US would have benefited immensely and better understood how they had been taken advantage of. But since Clinton's town-square gift for openness stopped well short of that, the public stayed uneducated. Indeed, even the new head of the Fed, Mr. Bernanke has still not learned the lesson of mixing free government bond hoards acquired with nothing down, and then pushing up interest rates "allegedly to "lick inflation."

Now note a couple of ancillary questions that we must ask Chairman Bernanke – and governor Dodge if he chooses to follow in his very flat footsteps:

Do these gentlemen feel that the banking system of either land is now in a position to repay the hundreds of billions of dollars of dollars they have loaded up with on a "risk-free" and "no cash down basis?" If so, they haven't been reading their newspapers. And have overlooked that the broad public is more strapped with debt than at any time in history. Our banks are in no position to pay for the hoards of federal debt than they were when they took them on, and if they sell them they will suffer losses that they can ill afford. As for the government surplus that was uncovered with the introduction of accrual accountancy, that has long since been frittered away in the extended boom leading to the high-tech bust of 2000, and in the Iraq war.

There is another vast and probably even greater unrecognized asset pool of government in human assets – education, health and social services. In the 1960s Theodore Schultz, of the University of Chicago had been awarded a Nobel Prize for Economics on the strength of the wild inaccuracies he and hundreds of other young economists been guilty of assessing how long it would take for Germany and Japan after their defeat to reappear as serious competitors of the US on the world market. "We could only conclude that we concentrated unduly on the physical destruction in these enemy countries, and overlooked that their main investment – their highly educated and disciplined population had come through the war essentially intact. From that his conclusion: that investment in human capital: education, training and hence, too, health and social services that safeguard the vessels in which this precious asset is kept.

The government is most unlikely to apply reasonable double-entry accounting to this remaining ignored capital of governments. But even if it should, without revealing to the public what such revised accountancy implied, it would fritter away the surplus from recognizing these still ignored assets in no time flat. As in fact it did in the case of the 1996 recognition of the government's ignored physical assets. There is no way of running a democratic government without adequate information available to the voters. That is the quandary of the current governments in Washington and Ottawa.

William Krehm

RENEW TODAY!
(SEE PAGE 2)

Deadweight Losses: Uncovering a Neoclassical Mystery Tale

One of the theorems that baffle readers of current economic textbooks is the theorem of deadweight losses. Its very name suggests a crime scene. The main culprits are revealed to be monopolists and governments, but since the monopolists still work within an – albeit flawed – market system, their sins aren't that great. On the other hand, when governments tax people it is bureaucrats with no stake in the outcome that distorts markets signals and reduce the economic pie available to us all. And that is beyond redemption.

The starting point of the deadweight theorem is the assumed existence of competitive markets with uniform prices. In such markets, the market-clearing price P_c will sell the quantity Q_c at the intersection between supply and demand (at point E_c in Figure 1).

In any market with uniform prices, there will be consumers willing to pay more than the going price, as well as producers willing to supply the market at lower prices. For consumers willing to pay more the differences are considered savings that enhance their overall utility prospects. In the case of firms willing to sell for less, the higher price they actually get is revenue above the minimum required for them to supply the market. Because of that, the differences are called consumers' and producer' surpluses.

If a tax is imposed upon transactions in a symmetric market, the burden of the tax will be distributed evenly between consumers and producers. Consequently, both will see a reduction of their surpluses to respectively P_t and R_t in Figure 2. The changed price level causes a suboptimal market equilibrium to emerge, in which only the smaller quantity Q_t, is sold. The tax revenue itself is spent other places in the economy, so its overall effect is dependent on how this is done. However, the reduction in the quantity appears to have vanished from the economy and is therefore called the deadweight loss.

The deadweight theorem also considers monopolies to be cases that can cause deadweight losses. A monopolistic firm sells differentiated products, enabling it to raise prices. Let us for the sake of comparison assume that the monopolistic price also is P_t in Figure 2. As before, the same deadweight loss and the same reduction in the consumers' surplus appear. However, the producers' surplus now includes the whole of the area up to the new monopolistic price.

Asymmetry and Market Failures

The diagrams used in the textbooks show markets that, even in the monopolistic case, appear to be symmetric. This creates a perception that product elasticities on the average are neutral. This is however not the case in modern markets, in which the demand and supply schedules have tilted so that product elasticities favour the monopolistic firms.

This tilt is however not just caused by simple product differentiation but also by a number of proactive marketing measures available to large corporations. Combined with corporate influences in other sectors of society, they create an envelope around the consumers that favour the corporations' economic goals.

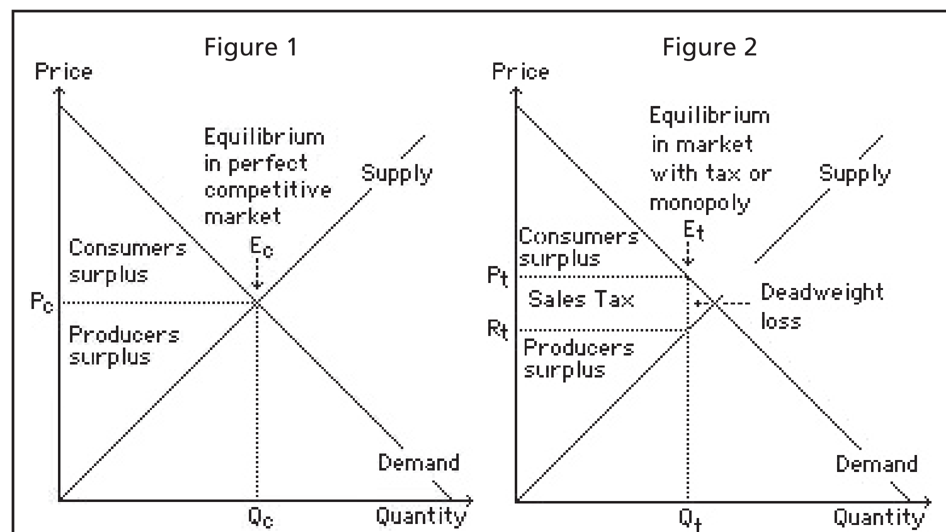
Standard economics only considers economic effects within a monetized market context. These it ties to utility measures expressed as monetary values, linked to the principle of willingness to pay. While benign monopolistic situations are acknowledged to exist, by showing willingness to pay consumers accept them as their best options. This reasoning, however, not only glosses over the fact that the monopolistic choices often are the only ones available but furthermore that they, as mentioned above, are underpinned by a sophisticated corporate machinery of market control.

The view also ignores that a market system, even at the best of times, is burdened by failures. This includes inability to deal effectively with externalities, free riding and the problem of how to price and cost allocate goods that are public in nature. And at the worst of times, when market conditions are asymmetric, idiosyncratic anomalies constantly arise. Without adequate countervailing forces to keep them in check, these become a fertile ground for further corporate rent seeking.

Using willingness to pay as a criterion for utility selection in a monetized market economy means that solving problems created by market failures depends upon market participants' willingness to pay for the counteracting measures. If they choose to free ride, they simply exercise a freedom to show unwillingness to pay, which the theory does not consider to diminish economic efficiency.

If we however had a situation where firms voluntarily installed equipment that remove for instance an externality that otherwise would be dumped into the public domain, this would be a production cost that raised prices. Let us assume that the price and quantities again will be the same as in the sales tax example. Let us then consider the case where the tax revenue is used to remove the externality (assuming that this technically and cost-wise would be equally possible). This would give us two parallel scenarios, with their main difference being how the removal of the externality is organized and cost allocated.

If internalizing the cost by firms is voluntary, the result, including the lesser output, now remains within the theory's criteria of efficient markets. On the other hand, if the same result is achieved through tax-funded measures that not everyone voluntarily accepts, economic theory considers the



reduced output a deadweight loss. But common sense says that the primary distinction is not how we cost- account procedures that remove externalities, but how important we as a society deem it to be.

Therefore, a tax used to pay for public activities that remove harmful consequences of production or subsequent consumption is not creating a "deadweight loss," but to the contrary eliminating a free rider gain, extracted by market participants that ignore the unallocated and socially degrading costs accumulating in the public domain. The socio-economic efficiency of markets and taxes do not depend on fixed theories, but on real conditions.

It is true that governments currently appear to be spiraling into a cycle of falling efficiencies, but the ascendancy of the corporate sector also has a hand in this. An example is the quickening speed of the revolving doors between roles as politicians and corporate lobbyists. This inevitably causes many politicians while ostensibly serving the public to look out more for the interests of future corporate clients. The exploding pay levels within the corporate hierarchies also means that is has become more difficult to find qualified candidates to fill administrative positions in government, and those who already work there are always looking for a chance to jump over to the much higher pay available for similar work in a corporate slot. But the cure for such inefficiencies is not to dismantle valid roles for governments but to make them function better.

Income Effects of Monopoly

When standard economic theory belittles the effect of monopoly it forgets that a precondition for successful monopolistic pricing is an ability to tilt demand towards more inelastic profiles. Otherwise, higher prices will not translate into revenue growth. The direction of the tilt also ensures that the reduction of surpluses and possible deadweight losses encroach mostly upon the consumers' side of the economy.

When prices go up under monopolistic conditions, the theoretical assumption is that new firms will be attracted by the extra profits, but this seldom holds true in modern markets where the price-setting corporations have successfully erected strong barriers to entry. They generally only need to fear attacks by other corporations. Sometimes price wars do break out between corporations vying for new opportunities of extra-normal profits. But most of the time the competing corporations strike a modus vivendi that restricts competition to a level that does not destroy their identical goals of extra-normal profits growth.

In modern contexts, the growing monopolistic profits are not just distributed as owners' dividends, but also as executive pay, the latter rising to astronomical heights in recent decades as corporate top executives increasingly control boardrooms. Since the mid-1970s this has returned society to a trend of rising incomes inequalities that can be directly linked to the deepening of monopolistic competition.

The income effects have incurred dramatic shifts in consumption patterns. As incomes concentrate at the top, it has been accompanied by a rise in consumption of luxury goods and over-dimensioned utility goods (such as the archetypal use of humvees for city commuting). Contrasting this, households in lower income brackets and in the squeezed middle class increasingly have been forced to flock to the cheap selections found in low-price warehouses.

The corporate impact on the changing consumption patterns has not stopped with the private sector. The public sector has also been impacted, largely by implementing policies built on the factitious claims of supply-side economics and its mantra of tax cuts. The results have been under-funded governments that have fallen behind in maintaining society's infrastructure and been forced to abandon former social goals. For instance, the eradicating of child poverty and extending enhanced development assistance to the struggling Third World.

The Positivist Pretense

Many modern economists claim that their science confirms the neoconservative social philosophy, and in line with this they deny that public purposes have economic relevance. For this, the theorem of deadweight losses has been hailed as an important proof. By putting monopolistic rents on par with government taxation – despite the wildly different consequences they have for incomes and maintaining public structures – the unsuspecting layman is nudged towards the conclusion that government taxation, by creating deadweight losses that diminish

The Drive to Get the Message into the Media

The following letter recently appeared in the Windsor Star *(21/12/05) under the heading "Free Trade is Not Free for Canada":*

Winston Churchill once said, "In War the truth is so precious that it must be protected by a bodyguard of lies."

When it comes to ruling Canada, politics is like war. The first casualty is truth.

When Paul Martin like his predecessors carries the banner for Free Trade, the truth is buried deep. The Canadian public must be shielded from the reality that their government is not representing them, but the interests of global corporations. Because "Free Trade" is anything but free.

It's not free when in order to keep these global corporations operating on Canadian soil, their fair share of taxes is shifted onto the shoulders of individual wage earners and pensioners.

Free Trade is all about who will benefit from Canada's immense natural resources. There's oil, priceless to the world, and so plentiful in Canada's sands and rocks. Under Ottawa's agency, what the global oil companies acquire for a few dollars, Canadians for their survival buy back at the world price of 50, 60 or 100 dollars a barrel. In the world of global trade, the water in Canadian rivers and lakes is a priceless resource waiting to be exploited.

To help them swallow Free Trade, Canadians are fed on the inevitability of globalization among with their daily coffee. The objective of globalization is quite similar to aggressive war: to appropriate control of a nation's economy and resources. A World Trade Organization far removed from democratic interference is assigned to monitor the benefits for global entrepreneurs and corporations. At every step, Canadians have regarded globalization with suspicion and downright hostility. On the other side, the promoters have the wealth and influence of international finance. With an agenda spanning decades and influence imbedded in the political parties, they have Ottawa. There has been no debate.

Wars have been won and lost without a shot being fired. Aware or not, Canadians are in a war that is in its eleventh hour. Given the stealth and power of the opposing forces, this may be the first war that Canadians lose

Don Waffle
Harrow, Ontario

the economic pie, always is bad; while free, unregulated markets always better.

As one laissez-faire economist formulated it: "Which policy is better: To tax or not to tax? If these are the only two options, economics has no answer. Clearly, consumers and producers prefer no tax, and the revenue recipients prefer a tax. However, our analysis has revealed [a] very important point...if your goal is to maximize the total gains to all members of society then it is best not to tax."[1]

This simplistic credo sees everything in narrow market context where externalities and infrastructure costs disappear from view, and free rider gains are considered part of that which allows markets efficiency to reach its postulated optimizing levels.

Under a cloak of false positivism, the social impacts of market imperfections and income effects are brushed aside as normative views, irrelevant to the serious economist. In the words of another laissez-faire economist: "Unless consumers are for some reasons more deserving than producers – a question that goes beyond the realm of economic efficiency – the monopoly profit is not a social problem."[2]

Such statements neglects the reality that markets, in direct contravention to the theory's claims, are not trending towards the assumed higher perfection, but to the contrary towards rising monopolistic concentrations.

Dix Sandbeck

1. Landsburg, Steven E. (1989). *Price Theory and Applications.* Rochester, p. 231.

2. Mankiw, N. Gregory et al. (1999). *Principles of Microeconomics.* Canadian ed.

France's Affair with Nuclear Power

France, land of Descartes and rationality, is taking great pride, if not without some trepidation, in having managed to make nuclear power the major source of its domestic electricity production. No less than 78% of France's domestically produced electricity comes from nuclear power, as compared with 28% for that of Germany, 23% that of Japan, 22% of the UK, 19% of the US and 13% that of Canada.

The Wall Street Journal (03/28, "With a Big Nuclear Push, France Transforms Its Energy Equation" by Jeffer Balls) sketches the picture: "Beaumont-Hague, France – Over the past three decades, the French government has transformed this 15-mile finger of land from a provincial backwater into one of the world's most concentrated patches of nuclear infrastructure. On an earthen pad carved from the cliffs squats a power plant with two nuclear reactors. It's expected to get a third. At the tip of the peninsula which juts into the English Channel, sprawls a power plant tightly guarded factory that processes spent nuclear fuel – not just from France, but from throughout the world."

Tackling the Problem

"Some in France look at this landscape and cringe. Others see it as a point of national pride. It stems from one of the world's most unflinching campaigns to curb fossil-fuel consumption.

"With oil dependence and global warming at the top of the international energy agenda, France's experience with nuclear energy is drawing interest from the US and China. The policy has slashed France's dependence on foreign energy and given it one of the lowest rates of greenhouse-gas emissions in the industrialized world.

"France's push hasn't been painless. The French government hatched and coddled a nuclear industry that has cost an estimated $120 billion. In doing so, the country has accepted risks. French plants have been hit by sporadic radiation leaks. Officials are now preoccupied by the possibility of terrorist attacks. Still unresolved is how to safely dispose of waste that will remain radioactive for millennia.

"Nuclear reactors generate electricity, which accounts for only 20% of the country's energy consumption. Oil makes up 49%, Though the country burns less oil today than before the nuclear push, its oil use is creeping up because of the rising number of cars and trucks on the road.

"The world will have to face hard choices before science comes up with definitive answers. There's mounting evidence that global warming is happening and that finding big new pools of oil is getting harder. If politicians and businesses act and these concerns prove overblown, they could waste vast sums of money. If they postpone action and the facts validate today's concerns, the future choices could be a lot harder.

"One recent day, Monique Prunier, tourism director for the region that includes the Beaumont-Hague plant, was pointing out how tax income from the nuclear industry has improved the area. Ornate street lights with buried electrical lines, a sleek new indoor public swimming pool.

"Over lunch of fish and cider at a restaurant overlooking the sea, she also conceded the costs. The cider was made by a local farmer but it isn't named after the region as is typical elsewhere in France. The name "Hague" in France is synonymous with nuclear power.

"Inside a nuclear reactor, enriched uranium is broken down in a process called fission that creates massive amounts of heat. The heat boils water into steam, which powers turbines to generate electricity. The reaction also produces plutonium, which is hugely potent; one gram of it holds as much energy as about fifteen barrels of oil. After the 'spent' nuclear fuel is removed from a reactor, the plutonium can be extracted and used to make a bomb.

"Some nuclear reactors are better for making heat, some [for making] plutonium. To burnish its credentials as a world power, France opted for a plutonium version when its engineers designed their first reactor in the 1950s. In 1960 France detonated its first nuclear bomb.

"At the same time, France started thinking about how to harness nuclear power for electricity. The country, which has no sizeable fossil-fuel deposits, was almost totally dependent on imports for its oil. To help tackle that problem, French engineers developed a reactor called a 'fast breeder.'

"Unlike a conventional nuclear reactor, which runs on fresh, enriched uranium, a fast breeder runs on leftover uranium combined with plutonium. It was envisioned as the ultimate vehicle for a self-sustaining French energy system – a guard against what French planners predicted would be a rise in the global price of uranium.

"In 1956, French oil imports were disrupted after Egypt blocked the Suez Canal. France, along with the UK and Israel, had invaded the area following Egypt's nationalization of the waterway. In 1973, Arab countries again threatened to cut off France's supply, prompting price spikes, and France vowed never again to be laid flat by a few oil-rich countries in the Middle East. It encouraged consumers to trim energy use and it launched a massive nuclear campaign, banging out six reactors a year.

"'France doesn't have oil, but it has ideas,' declared an advertisement that ran

on France's sole state-run TV station.

"The campaign was carried out by two state-controlled companies: Cogema, now part of Areva SA, and Electricité de France, then the country's electricity monopoly. The reactors were designed by Pittsburgh's Westinghouse Electric Co., now owned by Japan's Toshiba Corp.

"'It was Pittsburgh technology. We Frenchified it,' says Bernard Dupraz, an EDF senior vice president.

"In the mid-1970s, the Beaumont-Hague region got two big pieces of news. The government said it would build two Westinghouse-designed reactors in Flamanville, a tiny village on its west coast. The government also said it would enlarge an existing nuclear-processing plant at Beaumont-Hague to treat the spent fuel coming out of the civil reactors. Processing plants separate spend fuel into uranium and plutonium, which can be used, and high-level nuclear waste, which has to be disposed."

Processing Other Countries' Nuclear Waste to Pay for Nuclear Bombs

"To finance the expensive refitting job, France signed long-term deals with other countries – those who didn't have the political stomach to recycle nuclear waste in their own backyards. In effect France defrayed the cost of its own nuclear program by contracting itself out as a global nuclear waste processor.

"The decision to reprocess nuclear waste from countries such as Germany and Japan sparked a series of demonstrations in the late 1970s and early 1980s. 'The people couldn't accept becoming the trash can for the world,' says Yannick Rousselet, who participated in his first antinuclear protest in 1979 when he was 19. Today he works full time as the Beaumont-Hague region's representative for Greenpeace, the environmental advocacy group.

"As the French plowed ahead, the US was pulling back. The economic effects of the 1973 oil shock slowed the growth of the electricity demand, leading utilities to scale back on ambitious plans to build nuclear plants. In the late 1970s, concerns that plutonium would fall into rogue hands led President Carter to clamp down on civil nuclear processing. After the 1979 Three Miles Island disaster, the federal government ramped up nuclear oversight, leading some utilities to conclude that the cheapest option was to mothball their reactors.

"Today, the US has more reactors than any other country – nearly double the number in France – but they provide only 19% of the nation's electricity. It's proved far harder to construct an efficient nuclear industry in the US, where lots of utilities compete than in France, where the government is in control."

"France's nuclear program has never suffered a major accident along the lines of the 1986 disaster hear Chernobyl, Ukraine, or even a smaller incident such as Three Mile Island. Nevertheless, safety has been a constant worry.

"In 1997, a researcher at a French university issued a study that found 'some convincing evidence' that children who used beaches near the plant were more likely to get leukemia than those who didn't. In 2002, a government study of the problem concluded that it was impossible to link the additional incidences to either radiation or chemical releases from the nuclear facilities. The government is doing further work on the part of the study dealing with chemicals.

"At the Flamanville nuclear plants, officials beefed up fire-fighting capabilities, supplementing water used to fight conventional fires with special foam designed to extinguish blazes caused by jet fuel. The army set up a radar post at a nearby local airport.

"The state-run nuclear effort somehow placed bets that turned sour. The grandest part of France's nuclear vision – to run plants using left-over uranium instead of the fresh kind – flamed out in the late 1990s France had built three fast breeders for that purpose, including one called the 'Super Phoenix,' which cost several billion dollars. But the country decided the plants were unnecessary. Contrary to planners' expectations, fresh uranium remained affordable on the global market.

"In recent years uranium prices have risen, Some in France believe think fast breeders one day may be economically viable.

"Last month, after declaring in his January State of the Union address that the US is 'addicted to oil,' President Bush cited the success of France's nuclear strategy.

"Back at home, a series of public debates about a new Aveva reactor in Flamanville has exposed an unexpected fissure in French public thinking, France, like its neighbors, faces a European Union target to produce more electricity from 'renewable' sources, such as sun and wind. Because of its nuclear reliance, France lags behind many countries, notably Germany, in solar and wind power. This has led some to question whether the country's focus on nuclear power has been a strategic mistake."❧

Money and Power

The rise of inequality in the US (and to a lesser extent in Canada) has been amply documented over the past decade. Commentators on the left have generally blamed right wing fiscal policies, most notably the Reagan – Bush tax cuts. Establishment economists however, have attributed it to the "skill premium – the increased return to education" due to the information revolution, which has raised the incomes of the top 20%. This explanation was offered by Ben Bernanke, the new Fed chairman, in his first appearance before a Congressional committee.

In his column in *The New York Times* (Feb 27/06) Paul Krugman debunks this "80-20" fallacy. Using statistics from the 2006 *Economic Report of the President*, he shows that the incomes of college graduates have been rising at only 1% a year since 1975, lower than the rate of economic growth. In fact, those up to the 90 percentile have received almost no increase. The really massive gains have gone to those in the 99th percentile. Incomes at the 99.99th percentile rose 497% or $1,672,726! Now that's a "skill dividend"!

These figures validate our own experience, as our children and grandchildren struggle to secure decent jobs with benefits. Because of Medicare, lack of job related medical insurance is not the huge problem here as in the US. Pensions, however, are definitely disappearing and defined benefit inflation protected plans are becoming rare.

Krugman calls this trend "rising oligarchy." For forty years, from 1935 to 1975, the trend was to greater equality. Strong unions, government social programs, a progressive income tax, regulations and sensible monetary policy all contributed to this trend. Since 1975 the resurgence of right wing politics and economics have reversed the trend. The average worker has been conned into acceptance of the "market." As Krugman states, the rise of inequality reflects the ability of the power elite to influence policy, not the market. The gains our generation won, because of the lessons of the Great Depression and World War II have been taken away by a greedy, rapacious elite that seeks its' own enrichment at the expense of the majority.

David Gracey

Correspondence on the Bank for International Settlements

On March 10, Connie Fogal, leader of the Canadian Action Party, forwarded to me a communication of Bill Prouten which in part read, "I'd never heard of the Bank for International Settlements (BIS) before. I'm not surprised as to its existence, but I am continually dismayed as to the amount of control exercised by the 'elites' over the peoples of the globe.... Most of us have been working in the context of International Monetary Fund/World Bank issues, where BIS is rarely mentioned. We know of the ruling financial families – Rockefeller, Lehman, Rothschild, etc., etc., so it is very, very useful to have the discussion of the additional channels through which they exert power. Thanks for this additional piece of information."

Connie attached the copy of another letter from Ed Goetzen relating to BIS.

BIS Calls for Global Currency

By Paul Joseph Watson, Prison Planet. Com, 11/21/ 2006:

"Bank of International Settlements, considered to be the world's top central bank policy-[maker], has released a paper that calls for the end of national currencies in favor of a global model of currency formats.

"The BIS is a branch of the Bretton-Woods International financial architecture and closely allied with the Bilderberg group. It is an inner elite that represents all the world's major central banking institutions. John Maynard Keynes, perhaps the most influential economist of all time, wanted it closed down as it was used to launder money for the Nazis in World War II."

It is the inevitable result of the secrecy in which the very origins of BIS have been wrapped, that such secondary inaccuracies are often repeated.

BIS is most definitely not a Bretton Woods institution. Bretton Woods was a conference of allied governments in 1994 to plan the financial postwar set-up. Far from being "a branch of the Bretton-Woods financial architecture," at that conference Resolution 5 was adopted on the initiative of the Norwegian and other governments-in-exile, calling for the liquidation of BIS at the earlier possible moment. The reason? When the Nazis had entered Prague in 1938, BIS could not wait to turn over to them the gold reserves that Czechoslovak government had entrusted to it. For years no reference was be found to that Resolution 5. which obviously refers to the dubious background of BIS. I chanced to find at the Robarts Library of the U. of Toronto, stashed away in a dusty box, a highly relevant, but zealously forgotten booklet on BIS by Henry H. Schloss, an American academic entitled *The Bank for International Settlements*. To it I owed my first insight into the background of BIS. Some of the details appeared in my *A Power Unto Itself – The Bank of Canada – The Threat to our Nation's Economy*" (Stoddart, 1993):

"Until the late 1960s, ceilings were placed on the rate of interest that banks could pay their depositors or charge their borrowers. These ceilings were abolished in the stampede toward deregulation. At the moment there is no upper limit on interest rates in Canada except the one specified by the Criminal Code that prohibits rates of more than 60 per cent per annum."

Until the latter 1960s central banks held "inflation" [i.e., officially defined as any increase in the price index, no matter what might be its cause] in check by increasing the reserves that banks were required to hold with their central bank. This reduced the ability of the banks to make commercial loans. When a central bank wanted to "cool" the economy, it could call for a greater portion of the deposits it received from the public to be redeposited with the central bank and on this the bank earned no interest. That of course could be supplemented by the central bank raising the benchmark interest rate at which banks lent each other money for over-night loans when they were caught short to meet their obligations to the central bank. When the "market" pushed interest rates beyond what the commercial banks could charge, bank credit was automatically shut off, and really bad speculative orgies were smothered before they had seriously begun. In the latter 1960s, this power of the central bank to alter the statutory reserves came to require a special act of parliament. In 1991, an act was passed phasing out the amount of such statutory reserves entirely over a two-year period. That left higher interest rates as "the sole blunt tool" to fight perceived "inflation."

That, of course, put the financial sector very much in the drivers' seat. For interest is both the "meat and potatoes" of bank fare, and the gambling dice of the financial sector.

Resolution Five adopted at Bretton Woods for the liquidation of BIS at the earliest possible occasion, provided a very good reason for BIS cultivating a low profile in the shadows. In the early postwar years some of its offices in Basel, Switzerland, were housed, not behind fake Greek temple fascades, but over a bakery, where they were actually hard for *Forbes'* correspondents to find. That low profile, commended it as the semi-underground bunker of the banks' in which they plotted their comeback from the doghouse, to which they had been committed by President Roosevelt's 1935 *Bank Act.* Since most of the governments in the immediate postwar period were left-of-center – e.g., the Labour Government that replaced the war-hero Winston Churchill in Britain – most of the banks' comeback strategy had to be conducted not only *outside* governments, but in a sense *against* them. In his autobiography President Harry Truman recounts how at the beginning of the Korean War in 1951, his own Treasury double-crossed him when – behind his back – in their negotiations with the Federal Reserve, they agreed to doing way with the interest rate peg altogether instead of just arranging for it to be linked to the rising price level resulting from the *removal* of price controls in the US – at the very beginning of the Korean War that threatened to take on world-wide proportions. For such underhand scheming, BIS, a low-profile non-government organization and accustomed to operating with lights out, was ideally suited. No representative of a government – other than central bankers – is permitted to attend its meetings.

It was in this setting, that in the 1980s the bailout of the banks from their speculative losses in the 1980s was planned. None of this by its very nature could be presented to parliaments. Thus to replace the major bank losses during the 1980s in gambles incompatible with banking – e.g., the US Savings and Loans bankruptcies, and in Canada the banks' brainless plunging into the financing of builder Robert Campeau's sudden urge to collect US department store chains, the Reichmann's Canary Wharf mega-project gleaming skyscrapers before transport from the City of London was even seriously planned, and of course gas and oil. BIS sponsored the 1988 Risk-Based Capital Requirements. This declared the debt of developed (OECD countries) "risk-free,"

and thus requiring no additional capital for banks to acquire.

That allowed Canadian banks to quadruple their holdings of federal debt. All they had to do was clip the coupons of bonds that they could acquire without putting up a dime.

To make that possible, the Bank of Canada reduced its own holdings of federal debt. Since the Bank of Canada, nationalized in 1938, has a single shareholder – the federal government – the interest on any federal debt held by the BoC returns to the government substantially as dividends, thus resulting in a near-interest-free loan to the government. In essence this is but a continuation of the heritage of our ancestral monarchs' monopoly in the coining of gold and silver – known technically as "seigniorage."

Douglass North Sheds Light on Process

That privilege of the central government was foregone through the scheming of BIS, and the extra-burden on the government in paying interest for loans from chartered banks that they had up to then received from the central bank for virtually no interest, immediately led to the federal government slashing its grants to the provinces. These lost little time in passing on the compliment to the municipalities. This led to a drastic reduction in social services and education. Effectively, the banks had replaced the most needy members of our society at the head of the relief lines.

What was slashed had been identified by leading economists in the 1960s – Theodore Schultz and others – as the most productive investment that a country can make.

But that is but the merest beginning of a blood-curdling tale.

Not only were our banks bailed out, but they were further deregulated to enable them to plunge into further gambles on an ever more hazardous scale. This contradicts the banks' own practices in treating their clients: rarely do banks bail out a client who has gamed away his capital, Never, ever, however do banks equip a client whom they have bailed out with further capital with which to gamble on a more epic scale. But that is exactly what happened in the late 1980s and early 1990s: our banks, brought back to solvency at the public expense, were deregulated further so that they could take over the other "financial pillars" – stock market brokerages, real estate brokerages, and insurance – contrary to the costly les-

Continued on page 20

The Politics of Money

The word is out that economics, never a science, has always been politics in disguise. I have explored how the economics profession grew to dominate public policy and trump so many other academic disciplines and values in our daily lives. Economics and economists view reality through the lens of money. Everything has its price, they believe, from rain forests to human labor to the air we breathe. Economic textbooks, Gross National Product (GNP) and the statistics on employment, productivity, investment, and globalization – all follow the money. Happily, all this focus on money is leading to the widespread awareness of ways money is designed, created and manipulated. This politics of money is at last unraveling centuries of mystification.

Civic action with local currencies, barter, community credit and the more dubious rash of digital cybermoney all reveal the politics of money. Economics is now widely seen as the faulty source code deep in societies' hard drives…replicating unsustainability: booms, busts, bubbles, recessions, poverty, trade wars, pollution, disruption of communities, loss of cultural and biodiversity. Citizens all over the world are rejecting this malfunctioning economic source code and its operating systems: the World Bank, the IMF, the WTO and imperious central banks. Its hard-wired program: the now derided "Washington Consensus" recipe for hyping GNP-growth is challenged by the Human Development Index (HDI), Ecological Footprint Analysis, the Living Planet Index, the Calvert-Henderson Quality of Life Indicators, the Genuine Progress Index and Bhutan's Gross National Happiness…not to mention scores of local city indices such as Jacksonville, Florida's Quality Indicators for Progress, pioneered by the late Marian Chambers in 1983.

As with politics, all real money is local, created by people to facilitate exchange, transactions and is based on trust. The story of how this useful invention, money, grew into abstract national fiat currencies backed only by the promises of rulers and central bankers is being told anew. We witness how information technology and deregulation of banking and finance in the 1980s helped create today's monstrous global casino where $1.15 trillion worth of fiat currencies slosh around the planet daily via mouse clicks on electronic exchanges, 90% in purely speculative trading.

US President Bush embraced former chief economic advisor and new Fed Chairman, Ben Bernanke's opinion that the mystery of low bond yields and interest rates was due to a "global savings glut." Former Fed Chairman Greenspan, whose zero real interest rates flooded the US economy with excess liquidity and helped create the dot-com, housing and global asset bubbles, declared himself "perplexed." The anomaly involves the global economic imbalances between the USA, the world's largest debtor – borrowing the lion's share of global capital – and the developing countries of Asia and those exporting oil as the world's new lenders. I doubt there is a "global savings glut" or a "Shift of Thrift" from indebted US household's zero saving rates to thrifty Asian savers as claimed in *The Economist* editorial of Sept. 24, 2005. My view is that there's a global flood of fiat paper money – mostly trillions of US dollars – amplified by the pyramiding of financial "innovations" (derivatives, hedge funds, offshore "special purpose entities," currency speculation and tax havens) vis-à-vis real production of goods and services in the real world.

Today, we see worldwide experimentation with local exchange, barter and swap clubs, such as Deli-Dollars, LETS, Ithaca Hours and other scrip currencies in the USA and Canada. Billions of people still live in traditional non-money societies and the world's mostly female voluntary sectors. I have described these huge unchartered sectors as the "Love Economy" estimated by the Human Development Report (United Nations Development Program 1995) as $16 trillion simply missing from economists' global GDP that year of $24 trillion. Others have described these non-money sectors, notably Karl Polanyi; in Primitive, Archaic and Modern Economies (1968); Lewis Hyde in The Gift (1979); Genevieve Vaughan in For-Giving (1997); Dallas Morning News financial editor, Scott Burns in Home, Inc (1975); Edgar Cahn's No More Throw Away People (2004) and his time-banking programs now emulated worldwide (The Time Dollar How To Manual, www.timedollar.org).

All this hands-on experimenting resulted in an explosion of grassroots awareness about the nature of money itself. As local groups and communities created their own

local scrip currencies and exchange systems, they learned about economists' deepest secret: money and information are equivalent – and neither is scarce! As money morphed from stone tablets, metal coins, gold and paper to electronic blips of pure information – the economic theories of scarcity and competition began to be bypassed by electronic sharing and community cooperation. Barter, dismissed in economic textbooks as a primitive relic – went hi-tech. eBay, the world's largest garage sale, is an example of how to bypass existing markets.

People began to see how central banks and national money-systems control populations by macro-economic managing of scarcity, employment levels, availability of mortgages and car loans, via the money-supply, credit, interest rates and all the secretive levers and spigots used by central bankers. Even Nobel prizes were politicized as mathematicians in 2004 challenged the so-called "Nobel Memorial Prize in Economics" demanding its de-linking from the Nobel prizes and to confess its real name, "The Bank of Sweden Prize in Economics." The mathematicians, Peter Nobel, grandson of Nobel and many other scientists object that economists misuse mathematics to hide their faulty assumptions – and that economics is not a science but a profession. The row over the 2004 Bank of Sweden Prize was because its recipients had authored a 1977 paper with a mathematical model purporting to "prove" why central banks should be independent of political control – even in democracies. Central banking too, is politics in even deeper disguise, as I describe in "21st Century Strategies for Sustainability" (downloadable at www.hazelhenderson.com/recentPapers/21st_century_strategies_.htm).

Today, rapid social learning about the politics of money and how it functions is revealing this key mythology underlying our current societies and its transmission belt: that faulty economic source code still replicating today's unsustainable poverty gaps, energy crises and resource depletion. Climate change creeping upon us for 25 years is the latest media wake up call, and predictably economists quickly "captured this issue for our profession," as a UK economics group put it (Henderson, 1996), to promote their pollution and CO_2 trading "markets." In spite of such efforts, the defrocking of economics, the deconstructing of money systems and the growth of all the healthy local, real world alternatives is propagating widely. The World Social Forum launched in sunny Porto Alegre in 2000 by Brasilian reformers is one of many such worldwide movements. Argentina's default in 2001 taught its citizens that they could trust their own local scrip, flea markets and electronic swap systems more than the country's official currency: the peso. Argentina, Brasil and Venezuela have announced they will repay their IMF loans in full – to free their economies from "Washington Consensus" prescriptions.

Pioneers of Money Reform — An Unbroken Continuum

I have documented over the years many of the pioneers of money reform, from the Time Store in Cincinnati in the 1890s, Ralph Barsodi's "constants" in New Exeter, and during the 1930s "bank holiday," Vermont's own Malted Cereals Company scrip, issued in Burlington and the Wolfboro Chamber of Commerce's scrip in New Hampshire.

Margaret Thoren has kept alive *The Truth in Money Book* by Theodore R. Thoren and Richard F. Warner (from P.O. Box 30, Chagrin Fall, OH, 44022). Other perennials: E.F. Schumacher's *Small is Beautiful* (1973); James Robertson's *Future Wealth* (1989); Margrit Kennedy's tireless teachings; Robert Swann's *Community Economics* are all in the Schumacher Society's Library. The Society runs the SHARE credit system while documenting other community credit pioneering, such as Michael Linton's LETS experiments, Paul Glover's Ithaca Hours and many other projects since the early 1980s. Bernard Lietaer's *The Future of Money* (2001); Lynn Twist's *The Soul of Money* (2004); William Krehm's COMER newsletter (www.comer.org) and James Robertson and Josef Huber's *Creating New Money* (2004) continue to keep these lessons alive and updated. My bookshelf on alternative economics, barter, credit and currency system continues to grow, and includes Ralph A. Mitchell and Neil Shafer's indispensable eye-opening self-published *Standard Catalog of Depression Scrip of the United States in the 1930s* (Kranse Publications, Iola, WI) (1984). It contains thousands of pictures of alternative scrip currencies issued in almost every US state and city and many in Canada and Mexico after the Great Crash of 1929 and the bank failures that followed. During the 1980s in all my talks across North America advocating local self-reliance and alternatives to fiat money, I carried this heavy volume along to show how local inventiveness helped overcome the failures of national banking and finance. People would raise their hands in recognition as I would show on overheads the scrip used in their state. "I remember these in my Dad's bureau!" "My Mom used that to buy our groceries!"

So, today, as the global casino again reaches crises of abstraction, derivatives, currency futures and financial bubbles – we have been here before. Today's global imbalances, deficits, bouncing currencies, poverty and debt crises require a systemic redesign of that faulty economic source code. Worried finance ministers and central bankers call vainly for a "new international financial architecture." They do little but fret about this behind closed doors, at meetings of the G-8, WTO, and in Jackson Hole and Davos. Some clever libertarians try to beat the bankers at their own game with global digital currencies backed by gold, including e-gold Ltd, Gold Money and Web Money. Based in offshore havens, Nevis, Jersey, Moscow and Panama, they have become platforms for cyber-crooks (*Business Week*, January 9, 2006). The rest of us are redesigning healthy homegrown sustainable local economies – all over the world.

Before we fall into "either/or" errors, we should avoid doctrinaire "smallness," ideological localism and knee-jerk libertarianism. None can protect local communities from the ravages of market fundamentalist-driven globalization. Like it or not, we are all "glocal" now. Communities, like cells in the body-politic and the body, need boundaries or membranes to keep out elements destructive to the cell's integrity. But all cell membranes are semi-permeable to allow needed elements, information and energy exchanges from the environment to pass through. In today's information saturated world, communities need to understand anew which elements to reject and which to embrace. Wholesale rejection can lead to rigidity, xenophobia and misreading of history. Wholesale acceptance of current unsustainable economic global trends will surely lead to loss of local culture, biodiversity and resource-depletion. We humans have been adept at creating new scenarios and technologies that mirror our lack of systemic knowledge and foresight. From such social changes and unanticipated consequences, we must then learn and evolve – or suffer ecological collapse.

Hazel Henderson

Hazel Henderson, author of many books since Creating Alternative Futures with Foreword by E.F. Schumacher (1978, 1996).

Mail Box

Dear Mr. Krehm,

It was both enjoyable and informative speaking and more importantly listening to you.

When I sent an e-mail to Mayor Miller about the Bank of Canada's lending facilities to municipalities – below – his office referred it to Access Toronto which sent me a reply to the contrary. If you would e-mail what you read to me over the telephone, I will return it to Access Toronto requesting that it be given to Mayor Miller.

I will send you the letter to Premier McGuinty, printed in Bancroft.

Jerry Cutler

Dear Mr. Cutler:

Your e-mail addressed to Mayor David Miller was forwarded to Access Toronto, the public information and referral service for the municipal government of the City of Toronto.

The *Bank of Canada Act*, R.S., c. B 2 does not give the Bank of Canada the authority to lend money to municipalities. The Bank of Canada is permitted to lend money to the Government of Canada and to the provincial governments on a short term basis under sections 18(i) and 18(j).

Sincerely,

Robert Coate
Information Liaison Officer
Access Toronto / Public Information

Dear Jerry Cutler:

In reply to your letter and enclosed correspondence with Access Toronto about the Bank of Canada's lending facilities to municipalities, I will cite the pertinent sections of the *Bank of Canada Act* still in force and relevant to the matter:

"Chapter B-2

"An Act respecting the Bank of Canada

"Preamble. Whereas it is desirable to establish a central bank in Canada to regulate credit and currency in the best interest of the economic life of the nation, to control and protect the external value of the national monetary unit and to mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of Canada."

This sets forth the purposes of the Act and of the Bank of Canada. Note well the purpose is to mitigate "fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action" and not of prices alone by driving up unemployment at the expense of the "economic and financial welfare of Canada."

Next we must direct our attention to section 18 that reads in part:

"The Bank may:

"(c) buy and sell securities issued or guaranteed by Canada or any province."

This "buy and sell securities issued or guaranteed by Canada or any province" would also authorize the holding of any securities issued or guaranteed by Canada or any province. This takes care of funded debt of the federal government, or any province, or guaranteed by Canada or any province. Funded debt, of course, is debt organized as securities setting forth the terms of loans. What emerges from this subsection 18(c) of the act is that the bank has the power but is not obliged to (note "may" buy and sell securities") municipal funded debt guaranteed by the federal or a provincial government.

To clarify the detail of whether the BoC is obliged to do such financing, we must refer to section 14 of the Act subsection (2) which reads: "If, notwithstanding the consultations provided for in subsection (1), there should emerge a difference of opinion between the Minister and the Bank concerning the monetary policy to be followed, the Minister may, after consultation with the Governor and with the approval of the Governor in Council give to the Governor a written directive concerning monetary policy, in specific terms and applicable for a specified period, and the Bank shall comply with that directive."

As for precedents for loans made by the Bank of Canada to municipalities, in the very year of the nationalization of the Bank of Canada, 1938, when at great cost to the taxpayers of Canada 12,000 private bank shareholders were bought out by the federal government at a good profit (profits were scarce enough during those Depression years!) and Bill 143, 3rd Session, 18th Parliament, 2 George VI, 1938. "An Act to Assist Municipalities in making self-liquidating Improvements" was passed.

Note well, the very scarce funds raised from taxpayers during the Depression had as one of its purposes to save municipalities – especially in the Prairie Provinces – that were at the end of their tether. The sole shareholder of the Bank of Canada remains to this day the Government of Canada, and by virtue not of "funny money" but of the good old capitalist institution of the dividend, all interest paid on loans by the BoC to the federal government returns to it minus overhead expenses. Note well that is not the case of loans to the provinces or to municipalities that are not shareholders of the BoC. However, given the fact that under the Mulroney Government to bail out deregulated banks from their heavy losses of their capital in the 1980s, a series of measures originating in Basel from a non-elected central bankers' organization, the Bank for International Settlements (BIS) were adopted behind the backs of the parliaments of the world. The federal government has a serious responsibility for the plight of our municipalities. The principal legislation of this sort was:

1. The Risk-Based Capital Requirements sponsored by BIS that declared the debt of "developed" countries (members of the OECD) to be risk-free, hence requiring no additional capital for commercial banks to acquire. All they had to do was clip the coupons that replace the capital lost by Canadian banks in financing Robert Campeau, a well-connected Ottawa builder, in his sudden itch to collect US department store chains, about which he knew zilch; and the Reichmanns' glamorous skyscrapers at Canary Wharf before transportation from the City of London that they were to replace was seriously committed, or in Western Gas an oil.

2. Up to 1991, the Bank of Canada had two major policy tools for fighting "inflation" which, however, is not to be confused with any increase in the price index, but only such as can be traced to an excess of market demand over available supplies. The building of a subway in a city like Toronto, will require more taxation and higher living costs, but that is due to the greater layer of taxation to pay for the costlier vital services of a large city. These two tools for fighting perceived "inflation" had been from 1935 to 1991: (1) higher interest rates controlled by the central banks benchmark "bank rate" set by the BoC for overnight loans between chartered banks. (2) The statutory reserves, i.e., the portion of deposits received by banks from the public that they had to redeposit with the central bank on an interest-free basis. This usually ran from 8 to 12% in chequing

accounts, and far lower in non-chequing accounts, and by increasing these reserves when prices were pushing up, and decreasing them when prices were depressed, the central bank was able to temper its use of higher interest rates that hit everything within the economy whether or not it may have been contributing to "inflation" or not. The unemployed, who could hardly be contributing much to inflation, were particularly vulnerable to higher interest rates. By doing away with the statutory reserves – without debate in Parliament, or hardly a mention in the press – the central bank left interest rates "the one blunt tool" for "licking inflation." Since interest is the primary revenue, and the gambling chips of our banks, leaving that the "one blunt tool" for "licking inflation" meant an immense surrender of power to our banks who had just been lavishly bailed out at public expense.

What the Bank of International Settlements (BIS) had overlooked in its urgency to bail out the deregulated banks was the following: when interest rates are pushed higher, the bond hoards that the banks were allowed to accumulate with no money down, would shed value like mangy dogs do hair. For when newly issued bonds carry a higher coupon and sell at par, pre-existent bonds with a lower coupon will fetch a lower than par price.

This blunder of BIS and the central banks of the world almost precipitated the collapse of the international monetary system, beginning with the collapse of the Mexican currency and the Mexican banking system in December 1994. To prevent that from spreading throughout the world President Clinton of the US – even without the support of Congress – put together a $51 billion standby fund with the help of the IMF and Canada – the largest at that time on record. This had immense consequences for the world. It did not prevent the echoes of the Mexican monetary disaster to to spread to East Asia 1998 and Russia (the default on its foreign debt), but it reduced them to almost manageable proportions.

An important positive response was initiated by Clinton's Secretary of the Treasury, a savvy Wall St. alumnus, Robert Rubin, who at once grasped that loading up the banks with 100-leveraged bonds to bail them out of their losses, was simply incompatible with the BIS pushing interest rates into the skies to "lick inflation." As a result he brought accrual accountancy into the books of the federal government. Up to that point it had been the practice both of Washington and our federal government – and many provincial governments to treat all government spending whether for capital investments that could last for a half century or more just as they did their purchase of floor wax for their lavatories. They wrote them off in the year in which they were made, and beginning with year 2, they appeared on the asset side of the government books at a token dollar while the debt incurred for their acquisition was recorded in full.

Obviously such books could not and should not be balanced. Even the attempt to do so involved raising more taxes than were strictly necessary, and because of the unfavourably distorted balance sheet of the government lowered the rating given to it by the bond-rating agencies and resulted in higher interest paid by governments. Beginning with January 1996, the US Department of Commerce figures started carrying assets of 1.3 trillion dollars higher than had previously been shown. Unfortunately instead of listing them for what they were – government investments – they were shown as "savings," because it is a deep conviction of the "political center" that President Clinton was determined not to "lose" that the government could not make investments. "Savings" implies cash or near-cash form, which the rediscovered assets certainly were not.

That amendment of the US federal books brought in the long period of boom that climaxed in the bust of 2000. Canada profited from the repercussions of US policy in this matter, but as late as 1999 Finance Minister Martin was still arguing with the then Auditor-General Denis Desautels, who refused to give unconditional approval of two years federal balance sheets until accrual accountancy was brought in. In the weeks of argument Desautels even accused Mr. Martin of "cooking the books."

Eventually a compromise was reached, without serious explanation of what the crisis had been about in Parliament or in the media. Meanwhile to bail out the banks, they were allowed to take on another $60 billion dollars in federal bonds without putting up a penny of their own money. And the federal government had shifted debt from its own central bank where the interest paid on it came back to it as dividends to the chartered banks where the interest in question stayed with the banks.

The banks as a result replaced the most needy members of our society at the head of the relief lines. Vital social programs were, as a result shifted from the federal to the provincial jurisdiction, without adequate funding to pay for them. The provinces passed on this compliment to the municipalities, that have been left holding the bag.

And that is where we are.

But what a long line of Auditors-General had proposed and finally achieved did not cover the entire problem. Apart from the physical investments of government that has now been smuggled into the federal books, there remains the investment of all levels of government in human capital – education, health, and social services. In 1993, Theodore Schultz, of the University of Chicago, was awarded the so-called Nobel Prize for Economics for his work showing that the most productive investment a government could make. He reached that conclusion from studying the rapidity of the reconstruction of Germany and Japan from World War II destruction in a small fraction of the time that American economist had predicted would be necessary. His analysis showed the reason: the economists had concentrated on physical destruction and overlooked the importance of the highly educated and disciplined population of the two major defeated countries that had come out of the war essentially intact. Once that were incorporated into government's books, would not only be further improved but would be actually in surplus. What would appear would be a vast amount of financing of investment rather than a serious deficit. And for financing that the Bank of Canada had been set up.

Remains the question: the interest paid on government debt held by the BoC returns not to the provinces or the municipalities who borrow for their needs, but to the federal government. However, it is the federal government that carried out the bail-out of the banks and then rolled over disproportionate amounts of the cost of that onto the provinces, as the provinces did onto the municipalities. The federal government thus has a moral responsibility to share with the junior levels of governments the increased dividends that will flow to it from the financing of the investments of the provinces and municipalities. That is subject to agreements between the various government levels, and for just solution to be reached, the true history of the disastrous bank bailouts must be disinterred.

Without information democracy is simply not workable.

Our municipalities have a vital interest in learning this suppressed portion of our history.

One final point: in addition to the "fund-

ed debt" that the BoC is authorized to hold under subsection 18(c), there is provision for it to hold unfunded debt (i.e., more like current lines of credit of chartered banks) not to exceed one-third of the revenue of the federal government, and one-quarter of provincial government revenue, at any one time. Such amounts. it should be noted are immense, and obviously provide for roll-over renewal. That is an important part of the story but not the most important part. Please inform Mayor Miller and Access Toronto, that COMER will be happy to make available upon request any further information that they may wish on these matters so vitally important to the future of our municipalities.

William Krehm

The Blownup Myth of the Free Market

In the name of a "free market," economists have replaced everything that history had taught us about economics, with an imaginary model where prices lie flat. It mattered little to them that our industrial world could not function without ever more costly public infrastructures to support an exploding urban society in which even consumers require a considerable education and new technologies are constantly evolving. However, the obstinate fact is that the price level is determined not only by the balancing of supply and demand, but by the proportion of our mixed economy that is directly paid for by taxes. That is what makes our economy a mixed economy rather than a simple market economy. If you identify the economy with the market, and ignore the essential role of the state in not only defending the public Domain – the environment, public health, education and well-being, the physical infrastructures without which even the private sector could not function, you will be unable to understand the market itself.

To do so, establishment economists declared all goods and services not marketed for profit, "externalities," lying outside the pale of what they chose to call the "economy."

And by the time it became clear that prices would not stay flat, the financial interests devised some highly profitable means of trying to force them do so.

Clearly it would be in the interests of creditors and speculators for prices to lie flat, since that would keep the replacement value of their investments or gambles soaring while their replacement costs were nailed down or actually sank, as the real wages of the masses headed downward.

The central banks that were mostly either founded throughout the world during the Depression of the Thirties and after the war, had two major weapons for keeping prices and economic activities as level as possible. To prevent banks from going broke by not being able to come up with the deposits of their clients when claimed, they were required to deposit a modest portion of such deposits with the central bank. These also served other important purposes. They became an important source of government revenue to reimburse the government for its key function of supporting banks in trouble as "Lender of the Last Resort." The importance of that role had been made clear during the Great Depression of the 1930s when many thousands of banks throughout the world shut their doors.

And then again, when the economy seemed "overheated" – with the demand for goods and services outstripping society's power to provide them – the economy could be cooled by the central bank raising the proportion of bank deposits – especially short term ones – to the banks' cash reserves. That left the banks able to make fewer loans, and thus the economy was slowed down. The other tool for the same purpose was to raise the overnight interest charge for borrowing between banks. That rate was important because it served as the benchmark for many interest rates in the economy. However, when prices in the recovering postwar economy predictably refused to lie flat because the technological and urbanization changes society was undergoing, the banks of the world through their private organization, the Bank for International settlements in Basel, Switzerland, lobbied governments to bail out the banks from their losses in various speculations incompatible with banking during the 1980s and plotted their comeback to the position of irresponsible power that had led to the Depression of the 1930s and the Second World War.

Roosevelt's Other Financial Pillars Tumble

The US *Bank Act* of 1935, brought in under President Roosevelt, had forced the banks to stick to banking. They were forbidden to acquire stock brokerages, insurance and mortgage companies, and to use their pools of liquid reserve of these "other financial pillars" as a basis for the multiple of credit they produced For the very essence of banking is lending out many times the amount of cash the banks actually hold. Taking over these other financial businesses had added enormously to the banks political power by 1929 and brought down the world economy. By the 1970s they had lobbied themselves into such a position once more. And by the close of the 1980s, they had once again lost most of their capital in gambles in real estate, gas and oil, and other areas incompatible with banking.

They used their new political dominance to get out of that plight in some remarkable ways. The BIS declared the debt of developed countries to be risk free, hence requiring no additional capital for banks to acquire. This enabled the Canadian banks in to replace their gambling losses by taking n three times their previous holdings of federal debt – increasing it from $20 to billion to $80 billion, without putting up a penny of their own capital. All they needed to do to replace their losses was to clip the coupons of those bonds. The federal government, however, that had received the interest paid on the near one-quarter of its total debt held by the Bank of Canada in the form of dividends, began to pay out the corresponding bond interest on the federal debt that was shifted from the central bank to the commercial banks. It was a scam never seen before in the history of banking.

It is important to note that with every success in convincing their governments to bail them out, the banks enhanced their political power. The fact that these bailouts – diverting funds from social and purposes to the distressed banks – had to be carried out in stealth, put the government at the mercy of the banks. There are no chains that bind so much as complicity in deeds that won't stand the light of day. There is no other possible interpretation of the government's deregulating the banks' further *after bailing them out*. Thus they were allowed to take over the trust companies, stock brokerages and merge with other banks. That guaranteed that they would gamble themselves into still greater difficulties in no time flat.

The Globe and Mail (17/08, on the front

page of its Report on Business) carried news of the settlement out of court of the CIBC to the tune of about fully a quarter of its total capital with Enron – itself charged by the US government in one of the biggest scams in US history. The largest settlement already made and charges still to be faced in US courts have to do with so-called "partnership deal." As lead banker in the latter, CIBC designed the derivatives that kept liabilities off the Enron books and diverted many millions from Enron to the private accounts of a leading Enron executive who himself has been sentenced to ten years in penitentiary. Two other Canadian Banks – the TD and the RBC – are involved in the same scam. The taxpayers of Canada will absorb nearly $100 million of the CIBC settlement out of court with Enron since it can be charged against taxable profits earned by CIBC in Canada. Alongside this out-of-court settlement of two of our five largest banks, the Quebec sponsorship scams are mere misdemeanours. That this has not so much as rated a mention, let alone a serious background analysis by parties other than the minuscule Canadian Action Party, shows our election to be as rigged as the Enron partnership deal itself.' Was it for this that the support to the most vulnerable portion of the Canadian population had their social programs slashed?

William Krehm

Correspondence *continued from page 15*

sons learned from the 1929 crash by our governments. And there is an explanation for that seemingly incredible chapter of our history, for which the final bill has still to be presented.

The American economist Douglass North was awarded a Nobel Prize for Economics in 1993 for his studies on a recurrent phenomenon: when a basic redistribution of the national income takes place in a country, the political alliance in power until then is replaced by a new economic class or subclass, and a new political grouping takes over. With the monumental bailout of the banks – executed in virtual stealth without debate in Parliament or serious coverage in the media – a new combination of economic forces had come to power. In Mexico in the 1990s it was the equivalent of the old-fashioned military coups. But worse was still to come, something that proved that sheer raw appetite fuelled the transmitting of political power. Least of all, was there even an attempt to understand whether the right hand of the new rulers knew what the left hand was up to.

For the same BIS that from its conspiratorial cove had brought in the Risk-Based Capital Requirement Guidelines for banks, and abolished or weakened the statutory reserves, allowed the banks to hoard government debt purchased wholly on the cuff, proclaimed a final uncompromising crusade to bring inflation down to absolute zero. On May 23, 1991, Alexandre Lamfalussy, the General Manager of BIS, in his annual report, proclaimed: "It has been argued that inflation in the range of 1-2% may be considered price stability for all practical purposes. Nonetheless, the move from an environment of low or moderate inflation to one of no inflation implies an important psychological shift." And then he went on to compare the goal of "zero inflation" with the environmental debate: "As the environmental debate illustrates, it is by no means impossible to convince large segments of the population that the systematic undervaluation of future interests needs to be corrected. Something similar has also happened with the public perception of the need to combat inflation."

In actual fact, environmental clean-up and "zero inflation," rather than converge, are irreconcilable. Clean up the environment and take care of the other myriad social needs that have been neglected to bail out the banks and surrender to them the control of the economy, and a higher price level will inevitably result. That, of course, will not be more "inflation" but the inevitable effect of basic needs for the survival of our society. But BIS has shut its eyes to such obvious facts. It was prodding by BIS that had prompted Prime Minister Mulroney to attempt to put "zero inflation" and the "independence of the Bank of Canada from the government" into our constitution. However, his own caucus in the Finance Committee voted against the initiative.

The Illiterate Determination of Mr. Lamfalussy

But the illiterate determination of Mr. Lamfalussy persisted, until it narrowly missed bringing down the entire international financial system in a smouldering heap. Mr. Lamfalussy and the central banks had overlooked an important detail. If you bail out the banks by allowing them to accumulate allegedly "risk-free" government debt with nothing down, and then push interest rates to the skies to bring on "zero inflation," the market value of pre-existent bonds with lower coupons will crash, and your banks will risk becoming bankrupt once again under the weight of their allegedly "risk-proof" bonds. That is what happened in the collapse of the Mexican banking system in December 1994. Only an emergency standby fund of $51 billion set up by the US, the IMF and Canada, prevented the collapse of the world financial system. Still the incredible gap of BIS in mixing sky-high interest rates with allowing banks to hoard supposedly risk-free central government bonds acquired entirely on credit echoed on in the East Asian financial meltdown of 1998, the Russian debt crisis. A more positive result, for which BIS can claim no credit, was the shifting to accrual accountancy by the US government that retrieved $1.3 trillion in physical capital assets that had been written off in the year of their acquisition as though they were current expenditures. This appeared on the Department of Commerce books as increased "savings" which it most definitely was not, since "savings" implies cash, and the retrieved assets were in buildings, equipment, highways and bridges. However, the improved balance sheet of the government was effective in raising the rating of US debt by the rating agencies that brought down interest rates and assured a second term for Clinton. But, since it was not acknowledged for what it really was, the result cannot be considered durable. Under Greenspan the Federal Reserve brought in 14 successive quarterly increases in the benchmark fund rate, and his successor seems committed to several more. And that at a time when the nation is at war, and loaded with private and foreign debt as never before. Moreover, only government investment in physical assets has been addressed. The far more important stake of the nation in human capital is still ignored. In the 1960s Theodore Schultz was awarded a Nobel Prize for Economics for his work – based on the rapid reconstruction of war-ravished Japan and Germany after WWII far sooner than the experts had predicted. From that Schultz some two decades later concluded that human capital is the most profitable investment a nation can make. All this has been systematically ignored by BIS., as it stumbles on to ever greater disasters in its control of the world monetary system. It has wiped out the very Magna Charta, since Parliament can hardly be said to control the finances of the nation, if it is denied even the relevant information.

William Krehm