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The Fading Line between Crime and Art in the Deregulated and Globalized World

Pursuing our meditations on the ever dimmer line between art and crime in the ramped-up profit-ridden world, let us take a look at another offering of *The Globe and Mail* (14/11, "Trading on the Enron Mystique" by Ann Davis).

"Enron is dead! Long Live Enron!"

"Five years after the Texas energy trading giant collapsed, the traders behind some of Enron Corp's brainiest efforts to carve out new markets are pushing further into those frontiers.

"Enron alumni have joined hedge funds and trading operations capitalizing on fast growing commodity markets that the company once dominated or helped develop from its stronghold of natural gas and power trading in experimental futures markets, in pollution credits, and weather contracts. A few Enron refugees have even joined industrial or consumer goods firms, where they negotiate contracts to reduce the risks of volatile energy, food and raw materials prices.

"The growth of commodity markets popularized by Enron, and the ability of the veterans to raise money in building areas, is to some a validation of at least some of the [late] company's model for trading commodities of all kinds.

"'In the general population there is an Enron stigma. In the ruling community, however, there is an Enron mystique,' says Aya Vince Kaminski, a former quantitative expert at Enron. After Enron's Chapter 11 bankruptcy filing five years ago next month, the sought-after, risk guru moved to hedge fund giant Citadel Group, and then to Citigroup Inc.'s commodities desk. He now teaches prospective commodity traders at

Continued on page 2

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Crime *continued from page 1*

Rice University.

"Before imploding amid accounting-fraud accusations, Enron plowed big sums and talent into markets criticized after its fall as quixotic or a distraction from its core business of transporting energy. It had even investigated whether it could launch box-office futures as a way for studios to manage the risks of a big flop, a former executive who panned the idea recalls.

"While most markets besides gas and power weren't big moneymakers for Enron, ex-traders today are piggybacking on the company's early investments on everything from pulp-and-paper products to coal trading. And they are finding their background a selling point, much as the collapse and bankruptcy of junk pioneer Drexel Burnham, Lambert launched dozens of careers elsewhere in the 1990s."

Crime as the Ultimate Risk Management?

"'Employers look at having worked for Enron as a risk-management experience, and they think people might have learned something from the Enron mistakes and these traders may have become better,' says Michael Karp, chief executive of Options Group, and executive search firm that that works for many banks and hedge funds."

Or is it the appeal of slightly shaded high adventure as an enticing alternative to productive effort? A blessing or a curse depending on what fence you are sitting on in appraising the world.

"The traders' renaissance comes as some Enron executives from other areas whose reputations were tarnished by criminal and civil probes have forfeited assets and have begun serving prison time.

"Nowhere is the Enron 'mystique' stronger than with 32-year-old trader John Arnold, who founded hedge-fund Centaurus Energy LP in Houston with $8 million a few years ago and employs other Enron alumni. The firm now has an estimated $3 billion of assets and would be larger if Mr. Arnold hadn't returned many investors' cash and winnings to keep his fund from growing unwieldy, investors and traders say.

"Primarily a natural gas trader, Mr. Arnold did well last month in volatile markets even as Brian Hunter at Amaranth Advisors LLC suffered multibillion-dollar trading losses, commodities players familiar with Centaurus's performance say.

"Investors are rushing to back other Enron veterans. A Chicago-based fund of hedge funds have invested in a firm called Top Shelf Capital in Calgary operated by senior former trader John Lavorato and an Enron colleague, Jonathan McKay. They declined interview requests."

Undoubtedly it is a hazardous game in which modesty is a virtue that carries its own rewards. A knowledgeable player monitoring a limited market can become sensitive to its movement and identify a new surge of optimism – whether well-grounded or not. It is almost like a musician responding with a sensitive touch at the keyboard to great music. However, as success takes on ever more digits, such performance at the keyboard is responding not to a few *cognoscenti*, but to the heavy-booted push of throngs and there is no longer much to be sensitive to. Anybody addicted to sobriety will realize throngs are now entering an over-mature market but are too busy celebrating a great and final victory to get out with their booty in good time.

"Enron 'created a fantastic alumni network,' says Jeff Shankman, the former resident and chief operating officer of Enron's second-largest trading division. He is launching his energy-focussed hedge fund, Trident Asset Management, this week.

"Mark Tawney and another Enron alumnus, Bill Windie, were involved in Enron's early efforts to structure weather instruments for energy companies and other firms with payouts based on precipitation and temperature that affect their businesses. After finding that capital-intensive transactions worked best with a large financial institution as a credit partner, they moved on to giant Swiss Re to build up its weather desk and then left to form a weather-derivative-trading hedge-fund in Houston with a large financial institution as a credit partner. They then they returned investors' money and have just launched a weather-risk management desk in Houston, for a unit of Renaissance-Re Holdings Ltd., as Bermuda Reinsurer."

If a big enough financial partner is included to share sheer statistic hindsight – adjusting lack of foresight by raising premiums for the purpose – a strictly insurance operation may be useful and profitable. Unfortunately, planet warming makes the data of the past of diminishing usefulness which can only be dealt with by higher premiums.

Sorting out the sheer irresponsibility that flawed much of the Enron operation, much of its dubious profits would have been more plausibly assigned to a re-insurance fund to help rebuild future Louisianas.

William Krehm

Brought Home from the Bromsgrove Conference

Reminiscences of James Gibb Stuart

On 31st August, 1998, through the good offices of David Musa Pidcock, leader of the Islamic Party of Great Britain, I gave specific advice to Dr. Mahathir, then prime minister of Malaysia, with no great expectations that anything specific would happen.

After all, I had already been passing advice to Margaret Thatcher, Prime Minister of Great Britain – on matters highly relevant to this conference – advice, which had it been taken, might just have prevented her being thrown out of office. I had no indication that Dr. Mahathir would prove any more receptive or to what extent his thoughts were already moving in that direction. However, thanks to Dr. Mahathir's prompt reactions, taken in bold defiance of the IMF and other internationalist busy-bodies of that day, Malaysia escaped the worst effects of the Asian crisis, and Mahathir was generally acknowledged as the saviour of his country.

It was something that happened, and we can be quite specific on how it happened. For I brought the original documentation with me, in case the facts have got distorted in the telling.

If you do get hold of a copy, you will see that it touches upon a theme which is indeed central to this conference, when it advises the Eastern potentate to look inward at his own country's basic strengths, rather than borrowing in expensive US dollars. I'm telling him away back then in 1998, that on occasions legitimate government can create its own credit, and use it for essential national objectives – that very something opposed by the Establishments, by the media, the economic faculties, and our respective governments, who in effect sanction and legitimize a credit monopoly in private hands. This is what Paul Hellyer, a former Canadian cabinet minister, called "The most profitable scam in world history." So where did it all begin? I'll try to tell you.

Growing up as a boy in the West of Scotland, and exposed to a certain amount of intolerance, I grew familiar with a racist song which went somewhat as follows:

"King Billy slew the Papist crew
In the battle o'Boyne water;
The wee wall dugs took off their clugs
And paddled through Boyne water."

So who was King Billy? He was in fact William, Prince of Orange, "the wee German laidie," who was to take over the English (and Scottish) thrones in 1688, when the stiff-necked Stuarts refused to give up "the auld fiath" in favour of the new Protestantism.

A quarrelsome lad, was this King Billy. He had also gotten himself into a war with France, and was finding, with many kings, presidents and prime ministers after him, that wars are expensive diversions. They swallow up lots and lots of money. So when a certain Scots financier appeared, and offered to lend him 1.2 million pounds at 8% per annum, he went for it there and then. The financier's name was William Patterson. He and his fellow financiers took up the challenge, and were granted the sole right to lend money to the Government. It was a Royal Charter, initially intended for a limited period – subject to a review within a decade. But somehow it never got reviewed. Patterson and his associates formed the Bank of England. It was the beginning of the National Debt, the servicing of which had risen to about 11 billion pounds by the time when I was writing *The Money Bomb* in 1982. I forecast then that if this crazy situation was allowed to continue, in another 10 or 15 years, in another 10 or 15 years Britain's debt could have risen to 200 billion, with an annual borrowing requirement of about 25 billion just to pay for the interest charges. Well, one way or another, the situation has continued, and the interest charges had got to 25 billion, just in line with the forecast.

And needless taxes, coupled with a degree of institutionalized poverty – which is as constant feature of the debt-financing system – and a denial of the advance in living which we should all have enjoyed as a spin-off from the technological revolution, we as a people, in common with Americans and Canadians, are still paying for that charter granted more than 300 years ago.

W.K.

Keynes without Debt

This article originally appeared in issue 39 of Post-Autistic Review*, October, 2006, in the UK.*

As the power of "free market" capitalism takes ever deeper root in our 21st century, so also does human greed undermine society. Where once standards of behaviour imposed some balance between self-interest and social responsibility, today our governments seem intent on dividing the world into "haves" with ever more and "have-nots" with ever less. That generates discontent and terrorism.

The challenge is to humanize the current form of capitalism. We must recognize its current social cost – not only in the sense of the have-nots becoming poorer, but also in the ever higher price paid by the haves in terms of their vaunted life styles. If the wider infrastructures of society continue deteriorating, there will be no green and pleasant environment to enjoy.

A Practical and Specific Proposal

To this end there exists a practical and specific proposal that might be called "Keynes without Debt."

It embraces the economic principles of John Maynard Keynes. Currently unfashionable, among the neo-classical academics who espouse the supposedly free market, it was Keynesian principles that pulled the West out of the Depression of the 1930s and help the world recover from the ravages of WW2.

As the war was followed by the peace, the targets of full employment were achieved, so also the power of money began to grow again. In he 1980s a new economic theory developed – that of deregulating the money business in the expectation that the market place would produce economic equilibrium. Much faith was invested in Adam Smith's "invisible hand" a much misquoted version of the euphemism of the "I'm alright Jack" fraternity. Hypnotized by this delightful simplicity, and encouraged by a body of bankers and financiers who were obviously successful, the politicians of the era – most Thatcher and Reagan – committed the West to a world run by money as the prime mover of policy.

Not everyone was convinced about the log-term effects of this new revelation, but the money lobby condemned spiralling taxation and the cost of government borrowing as getting out of hand. The pro-Keynes lobby was unable to marshal a counter-argument. It was true that debt – both personal and national – was starting to spiral and Keynes's theories had never really come to grips with the role of money in the economic drama.

Keynes had eschewed abstract mathematical theories based on apocryphal as-

sumptions. He produced more practical theories than any of his fellow economists; and he dealt with the real world and its problems. He believed that government's job was to intervene when the free market broke down in social terms. However, he never really got down to the nitty-gritty of the money system. Government remained obliged to borrow from the banks to intervene effectively. And this increased taxation and/or an escalating national debt.

Of course, Keynes's *General Theory* was published in 1936, when currencies were still linked to the gold standard – indeed, the US dollar was on gold right up to the early 1970s. Keynes died in 1946, long before fiat[1] currencies became the norm. At that time half the money supply in the UK was spent into existence debt-free by the state and the other half was cheque-book credit. It is therefore not altogether surprising that Keynes felt constrained by traditional monetary theory and found it hard to look beyond borrowing from banks to finance public expenditure. The concept of "Keynes without Debt" addresses our current domestic crisis of resecuring our obsolete Public Services without creating taxation or dragging up the National Debt.

Now bank credit supplies virtually all our everyday means of exchange, and this brings into sharp focus the simple fact that modern money is no longer constrained by outmoded "intrinsic values." It is pure and simply a glorified accounting system based on government credibility. Keynes did see money in this light when he conceived his International Payments Union (Bancor). Briefly this was an international currency to be administered by the UN, whereby countries were encouraged to maintain a balance of payments and avoid excessive debt. Countries in surplus were encouraged to maintain a balance of payments by the application of negative interest and those in debt had to pay interest or devalue.

Unfortunately for the developing world, the US dominated the Bretton Woods Conference held towards the end of the war, and were not prepared to permit the mighty dollar to play second fiddle to anyone or anything – no matter what the logic for doing so. Even they knew that whoever controlled the world's currencies controlled political power. However, what is important is that now money is an accounting system that can be administered to serve any reasonable goal.

Modern monetary reform is about displacing the current economic paradigm of "what can be afforded" with "what we have the capacity to undertake." For governments the term "affordability" in terms of money is now a non-word. All new money emanates from government either as cash or as credit authorized under the Banking Acts. The value of the money in our pockets and bank accounts is a function of good government acting responsibly to maintain its value. Nonetheless, the financial establishment (now over a quarter of the UK GDP)[2] reckons that it knows best how much our government can afford to spend on public services and infrastructure.

Governments have issued debt-free finance for donkeys' years and spent it into circulation interest-free. It can be done again, given the political will. The evolution of credit over the past fifty years has replaced this source and replaced our means of exchange with private, interest-bearing debt. If government can issue Gilts and Bonds, it can issue credit to finance the rebuilding of creaking national infrastructures. When government once again shares the money supply 50/50 with banks we can reduce the tax burden and finance needed public services. Nowadays the roads of Wall Street and London's City are paved not with gold but with paper and computer chips. The money supply is all to do with business and maximizing shareholder value – and nothing to do with benefitting the community. It is the road out from a mixed economy into a frightening new world order where money buys power, both political and military. We need an alternative route. It's sign-posted – Keynes without Debt.

Ron Morrison

1. Money declared legal tender, without intrinsic value or backed by reserves.
2. Financial intermediaries – enterprises holding other people's money to make loans – were 27.6% of GDP in 1998. Abstract of National Statistics.

Battle of the Books

No, we aren't talking of this week's best seller, but books that, as a baker does his dough, mould our way of believing, living and dying. There is no more concise example of that than the relationship between the writings of Karl Marx and Georg Wilhelm Friedrich Hegel, the grand-dad of both democratic socialists and undemocratic Communists. Hegel, indeed, was the ultimate inspiration of both the Nazis and the Marxists themselves, and many many variants in the roomy in-between.

Such great books, each with numerous overlapping dynasties, have destinies of their own, that cannot be identified with the constraints of mere human history. Note the grand summing-up of the issue by Marx himself: "I took Hegel's system and stood it on its head." Do that and you risk getting mere human history a bit muddled.

That is what I was confronted with when I arrived at the Bromsgrove Conference on November 3. The occasion was the publication of yet another, great, if crudely unfinished book *The Lost Science of Money*, by Stephen Zarlenga of Chicago, who in the first 480 pages does an impressive job in tracking the development of money from a commodity to a fiat currency, with no further backing than the credit of the government that issued it. From there, he was apparently too anxious to crown his book as the official vehicle of monetary thinking, and skipped over some immensely important monetary developments such as the nationalizations of central banks a step long taken in most important developed countries. In the United States, however, the Federal Reserve Bank's shareholders are still private banks and not the government itself. Notwithstanding which, the earnings of the Fed – after an initial 12% dividend is paid on the capital of the Fed, paid by its bank shareholders – are still remitted to the federal government. However, under President Roosevelt, who had to declare a banking moratorium when over a thousand banks were shutting shop, much of the controls over private banking were pioneered in the US *Bank Act* of 1933, and were eventually adopted in the developed countries of the non-Communist world. It was a heroic leap skipping over that American pioneering in adapting fractional reserve banking to contemporary needs. However, Zarlenga, starting with his chapter 18, possibly to get on with the American imperative of promotion and advertising, omits the stories of the great Rooseveltian reforms. To this was added an insensitivity to what his proposal of 100% money through the abandonment of fractional reserve banking, would mean in other countries.

The Bank of Canada Act — A Gem not for Surrendering

Canada for example. has everything in its *Bank of Canada Act* – completely disregarded, of course – that had made possible the use the central bank in the public interest which was done from nationalization of the Bank of Canada in 1938 until the mid 1970s.

Why everything that was ever in the *Bank of Canada Act* that served to make

possible the golden age of socially-oriented banking policy is still in the *Bank of Canada Act* warrants telling. In 1982 when the Canadian Constitution was being drawn up, our PM, Brian Mulroney, was particularly attentive to Washington's spoken and even unspoken wishes. That is why Mulroney proposed putting "zero inflation" and the independence of the Bank of Canada from our government in our constitution. However, even Mulroney's own caucus in the Commons Finance Committee opposed the idea, and Mulroney didn't dare mess around with the *Bank of Canada Act* again. Undoubtedly, the Mulroney group would have been appreciative supporters of the notion of replacing fractional reserve banking with 100% money if Zarlenga carried the message to them.[1]

With this background, it made little sense for Zarlenga to come out for 100% money, which meant doing away with banking. For banking is the art of lending out at interest several times the money that is actually in the bank's coffers or on deposit with the central bank.

It requires complicated strategies for banks to be able to honor claims on deposits made with the banks. Its origins was with the goldsmiths who took on deposit the cash of merchants departing on long trips over robber-infested roads, carrying with them notes redeemable when presented to correspondents of the goldsmith with whom their own money was deposited. Without banking – and the bank multiplier – modern trade would have been unthinkable. It was a great invention – even a bit of miracle – and like all miracles, it requires careful controlling, to ensure that it does not tip over into crime. But it always involved much flair and skills winnowing out what borrowers are creditworthy, from those who are not. Banks today are ducking many of these indispensable chores which are the essence of banking – for example, by syndicating their loans and selling swaths of the parcel graded according to the degree of risk to private lenders that are simply not equipped to handle such essential debt management.

Bankers for reasons that the reader will grasp are not the most popular of humans – particularly since the controls have been removed that kept their art relatively free from too gross abuse. Much of this process is well recounted in the Zarlenga book.

But from there to 100% percent money which signifies the end of banking is a very long stretch. For the world stands in need of banking – the creation of near-money (i.e., interest-bearing money lent into existence by risk-taking bankers) As well, of course, as direct non-risk-taking lending by the central bank to the government which is interest-free. That occurs because the central banks in developed countries are invariably – with the notable exception of the US – government-owned, and thus the interest paid by the government to loans from them is virtually interest-free, spent not lent into existence.

The Variety of Banking Cultures

The Third World in particular stands in acute need of an appropriate banking system. There are different banking cultures in different lands. To meet the credit needs of the mouse-poor farmers in countries like India and Bangladesh, microbanking has evolved in recent decades; and within that a technically more efficient subsystem of microbanking has evolved that no longer depends on philanthropic input. Instead, it has developed efficiencies in standardizing repayment – the clients assembling at predetermined places at predetermined times with standardized payments, so that time will not be lost in making change for minuscule amounts. By such means the microbank collector is able to lower his collection costs and decrease the microbank's dependence on charity that is not always forthcoming. Instead, such banks are able to assemble and assess the credibility of the borrowers and by thus servicing the operation meet the needs of foreign banks. For foreign banks in countries like India have to show sufficient agricultural clients to be allowed to set up in these lands. An immense amount of ingenuity and effort has gone into such banking. To discard all this achievement, and scrap the crucial cuts of the history of many countries that are still documented makes no sense. Zarlenga should finish working on his book from chapter 18 at which point it seems to fall off a high cliff, from which the basic facts of recent banking development in the US and the world are missing.

On arriving at the Bromsgrove Conference – now in its tenth year – something was immediately apparent: all this had been missing at Zarlenga's American Monetary Institute conference that I attended in Chicago last year. Whatever the differences, of opinion – specifically on the matter of 100% money – at Bromsgrove there would be a democratic discussion, with both sides of the debate fairly timed, with the same cards denoting what remaining time is left to them. It was a different culture – if you wish a miniature version of the "mother of parliaments" model. To compensate for the absence of such virtues at the Chicago conference, those who had recently attended the second AMI conference of Zarlenga's brought back advertising staples – jockey hats with the AMI logo, books, pens and all the miscellanities – to show as souvenirs.

Allistair Connachie who introduced the discussion actually tilted his introductory remarks in favour of the 100% money, though he had been listed as a partisan of properly controlled fractional reserve banking. Fractional reserve reserves are at the very heart of banking. Reduce the banks to 100% reserves and they will have to raise their interest rates to cover the very considerable risks and the ever higher technological costs of banking. But more remarkable was Allistair's argument in presenting the 100% money point of view to a rivalry between two "Great Books." On the one hand there was Michael Rowbotham who emphasized the need for fractional reserves, that would provided the additional "near money" loaned into existence by the banks for private individuals and firms, as contrasted with the loans by the central banks to the government which would be "spent" into existence for capital investments by the government. In the latter case the interest paid to the central bank for the financing would come back to the government (or could be passed onto junior levels of governments by the central government for other considerations). And there was the book by James Roberston and Bunzel and that would strip the private banks of their powers of near-money creation and reduce them to the role as intermediaries charging a mark-up on loans that the banks had themselves borrowed and were paying interest on.

In his remarks Allistair had repeated the thought that the Robertson book had realized the full potential of the Rowbotham book. I made the point that what was there to be realized was not the potential of anybody's book, but the enormous strategic value of our history. That seems to have registered with audience, and a committee was named to put their impression in a formulation that will convey the crucial message to those still in the dark about the creation process of money in the modern world.

Unfortunately, neither Stephen Zarlenga nor James Robertson were able to attend the conference because of prior engagements. The crucial discussion, however, will go on.

William Krehm

1. The doing away with the fractional reserves was arranged by amending the *Bank Act* – a distinct law – in 1991.

The Propensity to Free Ride

In all societies useful products have been created and distributed through a mixture of individual and communal organization. Some key questions in this regard are: (A) how does utility match with costs and prices under such diverse scenarios, and (B) why do some products more naturally fall under one or the other of these two forms of economic organization?

For individually transacted products, the matter appears to be quite simple. In a market-place, people's willingness to pay is a measure of the usefulness they expect to get from the products in question. And, conversely, producers' willingness to supply is a measure of their expectations that there will be enough people ready to pay a price that will cover both their costs and a normal profit. According to standard economics, a normal profit is the maximum profit sustainable in a competitive market, since all attempts to gain higher profits will fail as there always will be producers content with the normal profit and willing to add to the market's supply at that price. In a market with only rational buyers (which is of course another key presumption of standard economics) no one will be willing to pay more than the normal profit price, the price at which the market supply is always ready to expand indefinitely. Thus, any supplier who tries to charge higher prices and earn more than the normal profit will find his market share collapsing.

However, when neoclassical theory on the basis of the above moves on to declare the superiority of such privately organized competitive markets, it leaves out many real-life situations. There exist useful products that simply cannot be separated into individual and exclusive units, a precondition for products to be sold in a market.

Already Adam Smith was aware of products with non-exclusive utilities, that is, economic jargon for products that once sold to one individual, other individuals cannot be excluded from also enjoying their usefulness. Contravening the modern myth that sees him as the father of extreme laissez-faire economics, he recognized that such products will be created only if the public does so. One example that he mentions is London's street lights, declared to be "public works of such a nature that they cannot afford any revenue for maintaining themselves."[1]

Social and Infrastructural Products

Not all products that modern states provide share this trait of street lights. Many products that typically are wholly or partly organized in the public domain are in principle exclusive and can quite easily be sold as private products. But the reason for maintaining them in the public domain is that if they were only created and offered through private market activities, they would not be produced in the quantities, and perhaps also not of a quality, desirable in a social perspective.

Such products are called social products and include products within the sectors of education and health care. Examples of fully exclusive products within these categories are not hard to come by, for instance a doctor or a team in an operating room can only treat one patient at a time. Others are created in part exclusively, as are many educational products. For instance, an extra student might be added to a classroom without increasing cost notably, nor diminishing the other students' benefit from the education. But if, say, eight or ten students were to be added to the class, the classroom would be filled above a tolerable limit and greatly reduce the teachers' ability to communicate with the students on an individual level. Hence the school would probably need an extra classroom and teacher. That, of course, would entail a significant extra cost.

Modern societies' willingness to treat education as a publicly funded social product is in recognition of its important role in modern democratic societies. Education became a public product in Western cultures during the nineteenth century. That made it a non-exclusive product, the provision of which was no longer limited by income, religious beliefs, nor acceptance of specific political ideologies.

This contrasts sharply with the conditions in many other societies and during earlier societal stages. In feudal Europe education mostly was organized as a private and exclusive product, which meant that only the elite could afford to have their children educated. In theocratic societies, education is often offered to somewhat broader groups but its availability is limited by the acceptance of a given religious dogma. Under such conditions there develops a strong tendency to restrict the content of the education to topics that confirm the socio-cultural superiority of the religious hierarchy.

Another class of products often best provided for by public bodies are infrastructural products. While they might be divisible into exclusive marketable products, competing choices are few or even non-existent, while on the other hand demand is broad and highly inelastic. In economic jargon, they are products with high degrees of natural monopolistic tendencies. If a highway in an urban area is turned into a toll highway run by an unregulated private enterprise, it often faces little competitive pressures due to the lack of alternative choices. For instance, in the typical North American city built around the gasoline car as the main transport solution, alternatives, such as public transport tends to be extremely inconvenient.

The Deadweight Loss of Monopoly

That makes it a potentially very profitable business for private enterprises to obtain and operate such products under unregulated conditions. An good example of what will happen if a privately operated toll highway is unregulated and thus left open to monopolistic pricing strategies is Toronto's Highway 407. It has seen its tolls rapidly rising since its opening. Originally the 407 was built with public financing, but before it was opened a new neoconservative government promptly "privatized" it (in the process selling it for a below-market price) without setting any serious restrictions on the private operators pricing policies. In defense of its actions it put forward the usual argument of laissez-faire market economics, that private enterprises always translate into higher efficiency.

But this will not happen when a product, as Highway 407, is facing a situation of low competitiveness and inelastic demand. In such cases. monopolistic pricing will limit aggregate utility by creating a monopolistic deadweight loss. In line with that, all products that have natural monopolistic tendencies will create deadweight losses that lower aggregate utility if supplied by a private unregulated enterprise. Another example of a new product in this category is broadband access, which in most North American jurisdictions are allowed to not only exist as horizontal monopolies (i.e., without localized competition within their

own product class), but furthermore seldom face any restrictions with regards to expanding into vertical monopolies. Thus they are left free to buy up content providers feeding into their primary product of the broadband network; a situation that further creates monopolistic pricing layers while at the same time diminishes buyers' aggregate utility by further reducing affordable choices.

A final group of natural public products are the measures needed to adjust for the effects of externalities. Externalities are utilities or disutilities that arise from products but only indirectly connected to the products' primary utility. The value gain or loss that these effects represent are therefore not included in costs nor pricing when such products are transacted in unrestricted private markets. In some cases, it is possible to adjust for the externality effects by adding subsidies or taxes to market prices. But often the effects arise through very indirect and complex processes so that the only practical solution is to treat the adjustments as true public products.

Paying for Public Products

The common features of public products are that their utilities either cannot be restricted to private purchasers, or that there will be a substantial aggregate utility loss if they are handled in that way.

Some kind of pooling of resources and money is necessary to solve this problem. In modern times, of course, the main method for solving the payment problem has been to raise taxes that pay for the various results deemed to be partly or totally a public responsibility.

Another alternative would be to pay for them through voluntary contributions. And indeed, in a number of cases voluntary contributions play some role in providing funds for classes of public products. Examples are research in health care products, and assistance to families living in poverty. But as a general approach to funding public products, the propensity to free ride is so overwhelming in the modern de-socialized urban societies that such funding schemes would fail. A tax system, with some measures of enforcement built into it, is clearly the only realistic approach for a general solution.

A Star Investment Counsellor Speaks his Conscience

Just in case your may have the impression that *ER* might be subject to obsessions about the utter social irresponsibility of hedge funds, we have this interview in *The Globe and Mail* (24/11, "Hedge fund loans pose risk: Sprott" by Boyd Erman): "As stock indexes in North America climb to records, influential Canadian money manager Eric Sprott told an audience of hedge fund managers in Toronto, acknowledging that the stance 'seems silly when the Dow is hitting new highs.'

"Mr. Sprott's belief that the markets are on shaky ground hinges on his assessment that there are numerous factors that could prompt a plunge in share prices, including the rapidly plunging US housing market and the possibility that the US dollar's value could crack under the strain of a yawning trade deficit.

"I'm the only person in the world, I think, who worries about the banking system,' he said. 'And I worry every day about the banking system.'"

Of course, Mr. Sprott whose analysis we respect, is guilty of a touch of solipsism there, because the entire monetary reform movement has worried and warned about the cliff towards which our deregulated banks are leading us. But many distinguished economists who have been eliminated from their posts in our universities, and deprived of the recognition and honours they have devoted a lifetime earning, so that even relatively well-informed critics of deregulated banking like Sprott don't so much as realize that the monetary reform movement as a whole exists.

The interview with Sprott continues: "He pointed to the 'tremendous leverage taking place within the hedge funds and the banking system,' he said. The biggest example, he said, is the burgeoning market for credit default swaps that allow funds to bet on the likelihood of companies defaulting on bonds. Most of the bets are made with borrowed money.

"It's gone absolutely bonkers and you have to debate whether it's a mania, said Mr. Sprott, whose firm, Sprott Asset Management Inc., runs assets of about $4 billion. About $1.5 billion of that is in the form of hedge funds, he said. Should the market collapse, banks could have trouble with loan losses, he said.

"It can happen – you can get too levered and anyone can go down.

"So far, while Mr. Sprott has been wrong on an all-out collapse of the US economy, his bets on energy, gold and uranium stocks have still enabled his firm to rack up big returns.

"So bearish is the money manager that he said that he hasn't in recent years been able to recommend investors put money into Sprott's own long Canadian equity fund. Instead, he steers them to the company's hedge funds. Too bad for those investors since the Sprott Canadian Equity Fund has risen 39% over the past year, about twice the return of the company hedge funds.

"'But should the market fall, hedge funds with their ability to bet on stocks falling are the defensive team,' he said.

"Because of his contention that banks and hedge funds are working too much with borrowed money, Mr. Sprott said he is an advocate of more regulation that would control leverage offered to hedge funds – not by rules on the funds, but by rules on the already regulated banks that would govern the amount of money that can be lent to managers.

"'There are lots of rules in place for regulated entities that should keep you out of trouble if the regulated entities stick to the script,' he said.

"He also suggested that hedge funds should be audited more often with tighter rules on who is qualified to check on the bookkeeping."

We publish below the media item on the Bank of Canada telling the Canadian public not to worry about the same hedge funds, whose sins the most vulnerable taxpayers are likely to be paying for on a scale that will dwarf what happened fifteen years ago. Time that private citizens started compiling files on what Bank of Canada chieftains were responsible for to help us deal with the next bank scandal and bail-out. The disregarded legislation still in the *Bank of Canada Act* makes our pretence of running a democratic political system a filthy joke.

Even though they have been hailed as a positive factor in our economic world by a Bank of Canada spokesman. (See page 8 of this issue.)

W.K.

But a tax system is also open to free riding. Firstly, the volume of tax returns to be processed every year is so large that it leaves many opportunities for making misleading or even purposely false returns. This condition, in particular, benefits high incomes households that can hire expert accountants that know how to exploit contradictions in the tax code and how to package misleading information.

Secondly, political parties and interest groups have sprung up with the main purpose of obtaining acceptance and legalization of the rising levels of free rider attitudes found among high income groups. This was the main focus of the Reagan-Thatcher era's original neoconservative movement, an endeavour that was given a stamp of approval by reigning trends in academic economics.

Subsequently, the neoconservative political movement experienced a spectacular success, in particular in North America where large groups of the populace nowadays embrace its social and economic prescriptions. This is also a result of the effects of the corporate infotainment and entertainments sectors that have played an important role in reinforcing anti-public attitudes and create a social environment in which free rider attitudes are rationalized as virtuous.

Under these circumstances, when people are given the choice of supporting a political party that promises to enhance the provision and quality of public products versus one that campaigns on a tax-cut platform that might give a typical middle income family a gain of, say, 300 dollars per year, many middle class families will, in the name of opting for immediate self-interests, cast their votes for the tax-cut party. That this entails giving high-incomes families, the tax-cut party's true support base, much larger free-rider gains fails to register. When, consequently, society's free rider losses accumulate, its ability to provide needed public products deteriorate correspondingly. In the end, of course, this will saddle the average middle class family with much larger utility reductions than the value of their original tax savings.

Dix Sandbeck

1. Smith, Adam (1909). *The Wealth of Nations*. Ch. 5, part III. New York: Harvard Classics Ed., p. 477.

RENEW TODAY!
(SEE PAGE 2)

Most Astounding Declaration of the Bank of Canada

Even *The Globe and Mail* (9/11) couldn't swallow the Bank of Canada declaration without a burp ("Bank of Canada applauds hedge funds" by Keith Damsell): "The embattled hedge fund industry received a ringing endorsement from an unlikely source yesterday – the Bank of Canada:

"'Hedge funds have had a largely positive impact on the efficiency of financial markets in Canada,' deputy governor David Longworth told a hedge funds conference north of Toronto. 'There appears to be no reason to sound the alarm.

"'Hedge funds reduce financial volatility and aid market liquidity,' Mr. Longworth said in his remarks. 'Risk is limited thanks to the varying investment strategies of large hedge funds and the risk management practices of banks,' he said.

"'Risks become more effectively managed,' he said. 'It's useful to note that the largely positive influence of hedge funds stems from their sophistication, their size, the diversity of their objectives, and the instruments they use.'

"Hedge fund executives said it was refreshing to hear a factual overview of Canada's $30 billion industry. Especially in the wake of a series of well-publicized scandals. Portus Alternative Asset Management Inc. and Norshield Asset Management (Canada) Ltd. are in receivership with investors owed hundreds of millions of dollars. In the US, Amaranth Advisors LLC lost about $6.6 billion (US) in September on disastrous wrongway bets on natural gas by Calgary-based energy trader Brian Hunter.

"'The Bank of Canada gets it,' agreed Gary Selke, president of Toronto's Front Street Capital, manager of close to $3 billion (Canadian) in hedge fund assets. 'Recent scandals have more to do with fraud and risk management than the principles of hedge fund investing,' he said.

"A parliamentary committee is currently studying the hedge fund industry, just a few weeks after a private sector task force proposed new regulations that would make the higher-risk funds more accessible to retail investors."

Strangely enough, you could almost pick up one of the major US business newspapers and find howling evidence that hedge funds are bending and breaking the laws that were supposed to assure a fair market for investors, pension funds, and whatever, great and small.

The Two-timing Romance of Hedge Funds

For example *The Wall Street Journal* (01/011, "Is Your Fund Manager Two-Timing You?" by Eleanor Laise) writes, "A Growing number of money managers are juggling multiple roles, handling plain-vanilla mutual funds for mom-and-pop investors as well as huge funds for wealthy individuals and institutional investors.

"Regulators and lawmakers have raised concerns about the trend, saying it could lead managers to favor deep-pocketed hedge-funds over the smaller fry investing in mutual funds. Some major fund companies, including Vanguard Group staunchly defend these so-called side-by-side management arrangements. Others, such as Fidelity Investments, avoid the practice. New academic studies are divided on whether small investors are well-served by side-by-side management.

"For fund companies, hedge funds – private investment pools for wealthy and institutional investors – can be much more lucrative for brokers than mutual funds. Hedge funds often charge a 1% or 2% management fee, as well as a 20% performance-based fee, while the average mutual fund charges a management fee of 1.5%. Hedge funds' hefty performance-based fees could give managers an incentive to favor those over mutual funds – say by allocating their best investment opportunities to hedge funds.

"Mutual funds sharing managers with hedge funds include Vanguard, Pioneer Investment, Nationwide Mutual Insurance Co.'s Gardmore Global Investments and Ameriprise Financial Services Inc.'s RiverSource Investments. Such arrangements account for a small but growing slice of the fund universe, industry experts say. There are 124 individual portfolio managers simultaneously running mutual funds and hedge funds tracked by investment research Morningstar Inc., compared with 112 last year and fewer than 60 in 2002.

"Critics say that the practice gives managers an incentive to favor hedge funds with

their best investment opportunities. Some moonlighting managers acknowledge the possible pitfalls. A number of major fund companies steer clear of the practice. American Century Investments offers a traditional mutual fund that uses hedging strategies, and such funds 'are a better deal for shareholders,' says Phillip Davidson, a senior vice president of the firm. Fund giant Fidelity has no in-house hedge funds and prohibits managers from running outside ones.

"Other major players, however, defend side-by-side management. 'It allows us to look at a very broad universe of managers and hire the best we can find to run money for our shareholders,' says Jose Brennan, principal of Vanguard.

"In 2003, the House of Representatives approved a measure, later shelved, that would have barred an individual from running a hedge fund and a mutual fund simultaneously. In congressional testimony earlier this year, Susan Wyderko, the director or the Securities and Exchange Commission's Office of Investor Education and Assistance, said that the practice 'presents considerable conflicts of interest that could lead the adviser to favor the hedge fund over other clients.'"

The Shelving of a Useful Restraint

"A manager might sell shares of a stock in his hedge fund before his mutual fund, because he knows the sale could drive the price down. Instead of assigning a trade to a particular fund at the time it is executed, he could 'cherry-pick' trades. He may make a trade in the morning and assign it to the hedge fund or mutual fund later in the day depending on its performance. And a manager who has access to a limited number of shares in an Initial Public Offering, might favor the hedge fund with them.

"Shorting stocks, a strategy often used by hedge funds that typically involves selling borrowed shares with the hope of buying them back later at a lower price, can also lead to potential conflicts. A manager may have a short position on a stock in the hedge fund while holding a long position – a bet that the price will rise – on the same stock in the mutual fund."

Could it be that the high officials of the Bank of Canada do not read the US business press? Or for that matter their own charter, the *Bank of Canada Act?*

W.K.

REVIEW OF A BOOK BY JEAN-CLAUDE DELAUNAY, FONDATION GABRIEL PERI, 2006

Le dollar, monnaie mondiale

Both the author of this extremely interesting analysis of Washington's debt position and the reviewer owe a great deal to François Perroux, a masterful French economist, who today – as Delaunay notes – is wholly forgotten even in France. He is one of the "Great Forgotten Economists whom we sorely have need of as we hurtle to every greater, blinder catastrophes. One of his greatest contributions was his grasp of the power element – his "Dominant Revenue" – that he tracked down through the ages. As Delaunay so well shows, it can be immensely helpful in guiding us through the thickets of confusion of current economic theory.

To set the stage for his analysis, the author establishes the three basic functions of money, that will guide him in his analysis of the US debt position:

1. As a measure of the economic value of commodities not only in commercial circulation, but stock-piled, goods in the process of production, as well as financial assets. Money in this aspect is a unit of accountancy.

2. As the means of putting into circulation the economic essence of merchandise, both that being marketed to its ultimate consumers or still stocked. In this aspect money ensures the circulation of merchandise at whatever stage of its production and delivery.

3. A means of accumulating and handling the economic value of the goods without reference to conserving their specific usefulness over time. This aspect of money might be described as a *reserve of value.*

Distinguishing these three functions of money is essential to an understanding of any monetary operation, and the author applies it in his analysis of Washington's hazards arising from its acceptance by the rest of the world as the main reserve currency, and its role as the purchaser of the last resort for the rest of the world.

Money as a Social Tool

One can improve this analysis by noting that those agents, private or governmental, who satisfy their monetary needs with American dollars while living outside the US occupy a special position. Marx wrote that money is a "social tool." This implies that money is the means whereby value that is produced in a decentralized way is put into a social context. Indeed, money is the form assumed by the economic unity of the world. However, in a jarring note, it is also the means of exercising economic power over other nations. We thus arrive at the basic analysis of the "dominant revenue" or the "dominant economy," of François Perroux.

Let us begin with the monetary figures related to the trade in merchandise. A study carried out by the European Community fifteen years ago, showed that in 1980 56% of the world exchange of goods was invoiced in US dollars, 48% in 1987. Another study covering the period of 1973 to 1990 provides a lower figure – 35%. The best known of the products denominated in dollars are oil, metals. More frequently, manufactured goods have their prices quoted in the currencies of the countries in which they are produced. But that is not always so. The products of the aeronautical industry are quoted in dollars, a detail that creates immense difficulties whenever the exchange rate of the dollar goes down. But more important has been the financial globalization that endowed the US dollar with a renewed importance as the preeminent currency of the world. In 2004, the US stock markets attained a total capitalization of $16,324 billion, while the stock exchanges of Europe and Japan respectively reached $9,300 and $5,850 billion.

The figure for long-term loans provides further insight into the dollar's role as world reserve currency. In 1982 and 1992, the obligations in eurodollars (i.e., the dollars delivered outside the US by non-American banks or branches of American banks) amounted respectively to 56% and 41% of the total obligations undertaken in the world. One must conclude that on the world capital markets, borrowers have a vital "need" for dollars. But amongst these borrowers are the US state and the US economy. For the US currency is the first choice of borrowers, whether they happen to be developed or underdeveloped countries.

There is yet another "place," electronic and virtual, where the preeminent worldwide position of the dollar is evident. This

allows investment or borrowing according to need; and there the standard currency is the American dollar. From the relevant data it is clear (1) that the dollar is the currency most bought and sold in significant places; (2) London is the most active market where every day the greatest amount of dollars are exchanged; (3) the Asiatic countries do the highest proportion of their trading in dollars; (4) ever since the 90s there is a tendency for an increase in the proportion of exchange transactions carried out in dollars, with the exception perhaps of Japan.

The Phenomenon of "Dollarization"

The term *dollarization* refers to the total or partial replacement of a local currency by the dollar. Take the example of Ecuador, a politically independent country in Latin America with a currency known as the *sucre.* In the year 2000 the government of that country, in agreement with the political authorities of the US, decided to replace the national currency with the dollar. Since then the dollar has replaced all the functions previously filled by the local currency with the exception of the coins. Ecuador has been "dollarized."

It is significant that since the decade of the 1990s, several countries of Latin America have either taken this step or announced their intention of doing so.

Dollarization may take an official form, as in the case of 14 territories or countries: Porto Rico (1899), Panama (1904), Salvador (2001). It is notable that the trend to official dollarization has slowed down as a result of the disaster experienced by the Argentine in 2001-2. Dollarization may also be *semi-official,* making it perfectly legal for the residents to keep dollar deposits in local banks in addition to deposits in the local currency. According to an estimate of the IMF in 1995, there were about fifty such semi-dollarized countries, of which 18 were "highly dollarized." Such countries were to be found in the Caribbean, the successor countries resulting from the dissolution of the Soviet Union, Vietnam.

After the definitive abandonment of the gold standard in 1971, the capital of the world entered a period of erratic monetary values, and floating exchange rates. Yet the globalization of capital continued on its upward course. Capitalists felt the need for more stable monetary instruments for their investments, On the other hand the heads of the underdeveloped countries, strangled by the extremely high interest rates, and driven to export to service and repay their debts, found it less and less possible to attract the capital needed for their development while undergoing unavoidable devaluations of their currencies. Dollarization was an extreme form of this trend.

American investments going to Europe have gone into finance and banking to a greater degree, while more of the movement in the opposite direction have gone into commerce and service industries.

However, assuming that a dollar crisis should actually ensue. Two distinct types of risk are conceivable:

1. An immediate drop in the exchange value of the dollar might ensue. This would have a probable partially corrective effect, since it would reduce the real value of the American debt held in Europe denominated as it is in dollars. An important result, however, would be the losses suffered by the capitalists holding the American debt. Their potential contributions to the prosperity of countries like China would accordingly shrink.

2. A strong increase in interest rates, to increase confidence in the dollar by attracting more investment into the US rather than from it.

Are Higher Prices Always a Disease?

The author proceeds to dismiss any serious "inflationary" effects from higher interest rates. "The condition of the dollar system is not, however, perceived currently critical for other reasons than those mentioned." In the OECD zone – the thirty-odd developed countries, the variation of prices – between March of 2005 and 2006, excepting higher energy costs, have moved up only 2.6%. That is generally explained by the effects of globalization and importations. But here the weakest aspect of the Delaunay book appears. "Inflation" cannot be considered a single disease of the economy – or even as necessarily a disease – because very different economic causes, some inevitable, others pathological, may share the same symptom of high price indexes.

That might be due not to an excess of Demand over available Supply, which to our mind is a proper description of "price" inflation. Another very different disorder giving rise to higher price indexes could be faulty government accountancy, that treats investments of government as a current expense, depreciating them entirely in the year when made, and then carrying the value of a building, a bridge or a highway at a token dollar. Since that would present the budget in unseemly deficit it would drive up the benchmark rate of the central bank.

In the early 1990s, the US government bailed out its banks after the BIS declaration the debt of developed countries "risk-free" and consequently requiring no down-payment for banks to acquire. This allowed the banks to load up with government debt with practically all the interest paid on such Fed-held government bonds going to the banks as "seigniorage," paying it to the private banks whose coffers were replenished in this and other ways.

Mr. Alexandre Lamfalussy, manager of BIS, proclaimed "zero inflation" the only acceptable goal. The plight of the deregulated banks had been so desperate from the massive loss of their capital in deregulated adventures, that M. Lamfalussy – and central banks around the world – overlooked the detail that when interest rates soared, the government debt hoards that had by now gone far to replace the banks' lost capital would shed value. That brought down the Mexican peso by some 40%.

The entire world financial system tottered, but was saved only by a standby fund of some $51 billion US put together by the US. The IMF and Canada. More decisive for the longer run was the move by Clinton's Secretary of the Treasury, Robert Rubin, in bringing in accrual accountancy (a.k.a. capital budgeting) and carrying back the revision of the government books to 1959. This retrieved some $1.3 trillion in government assets. This entered the Department of Commerce figures under the heading of "savings" – which it most definitely not since it was not cash or near-cash but long since invested in bricks, steel and concrete. However, a wink and a nudge to the bond-rating agencies produced the desired result: the ratings of government debt soared and interest rates dropped. That gave Clinton a second term, and the stock market the high-tech boom that soared until it bust in 2000.

The Need to Rediscover our Suppressed Great Economists

That is all a crucial part of the tale that Delaunay has missed, largely because he apparently abandoned much of what he should have learned from Perroux's masterful destruction of the self-balancing market model. But then that is part of the immense tragedy of François Perroux – and of many other great economic thinkers – that at the very end of his life, finding himself increasingly expunged from the official world of

economics, he made a feeble attempt at reconciling his great contribution in devastating the free, self-balancing mathematical model, in a half-hearted conciliatory review of some youngster's efforts in the field.

And from there we get Delaunay's discussion of "inflation" as though higher prices were one of the bed rock established certainties of economics rather than a grab-bag of very different causes, with the common symptom of rising prices. The ultimate tragedy of François Perroux caught up economists across the world in varied degrees. A key part of the COMER mission is to retrieve and put into circulation again some of the great creative work of leading economists that has simply been expunged, along with the very memory of their existence.

Fortunately, Delaunay is able not only to preserve Perroux's theory of power – embodied in his "dominant revenue" that takes the flow and mass of the revenue of a given social class an index of the welfare of society as a whole. This he extends to embody the realities both of globalization and the current world preeminence of the United States.

"For François Perroux, power was the great forgotten factor. Let us keep in mind the ability of the dollar to drop in value without that reducing the world demand for that currency. This occurs for several reasons: (1) As the dollar forfeits some its value, the value of American investments outside the country rises; (2) the value of the foreign investments in the US declines; (3) A stimulus ensues for foreign capital to seek investments in dollar areas to profit by the cheapened dollar."

All this has another aspect than the purely political one. The unique position of the US dollar provides a powerful means of exploiting labour in the countries subjected to dollar supremacy – of appropriating a further part of the surplus value produced.

The "dollar system" is more than just the means of financing the American trade balance. "It is an immense *gulf stream* of capital heading to irrigate key financial and productive areas of the world economy. The 'dollar economy' adds up to *a world-wide economic social machine lifting the US to the status of dominant economy.* In this role it pursues two main goals: (1) Establishing a systemic control of 'the enemies' thus reinforcing the military and diplomatic controls of their economies; (2) Exploiting 'the enemies' to their very bones. More than just a political instrument it is a means of appropriating wealth."

Viewed by other cultures subjected to such currency domination, the prospects opened up are less than reassuring. Is it not time that we returned to Keynes' abandoned effort at Bretton Woods to devise a monetary medium more conducive to a harmonious co-existence of different cultures?

W. Krehm

The High Moral Cost of Cooking the Books

Under the heading "Ottawa Planning More Cuts to Climate-Change Programs," *The Globe and Mail* (25/11) informs us that "The Conservative government is planning a second wave of cuts to climate-change programs. It is asking public servants to help manage the 'fallout' by explaining why their positions should disappear. Government officials who manage the programs extended by one year in April will not be renewed.

"Government officials who manage the programs were told this week that programs extended by one year in April will not be renewed.

"The officials are being asked to compile information as to who would most likely be affected and what the public reaction would be.

"The project is being described internally as 'government-wide' and *The Globe and Mail* was able to confirm that at least two departments, Natural Resources Canada and Agriculture Canada were submitting reports this week.

"Environmentalist John Bennett of the Climate Action Network, who has met in the past with those in charge of Agriculture Canada's climate programs, said it is inappropriate to involve them in such a communications plan.

"They were all very committed to the programs they were working on, he said. 'So for them to be asked to explain why they should be cut, really it's right out of George Orwell's *1984.* It's telling bureaucrats to come up with lies to justify government policy.'

"Five climate-change programs at Agriculture Canada will be shut down. They include:

"A $5 million project called Model Farms program to develop estimates of how much carbon can be removed from the atmosphere through new farming practices.

"A $21 million project called the Greenhouse Gas Mitigation Program for Canadian Agriculture, meant to involve farmers in the government's campaign to reduce greenhouse gases by encouraging farmers to line their fields with trees to reduce wind and control snow piles.

"A program dealing with manure management and a fifth program dealing with the role of farmers and 'future fuels.'

"The plan is being led by Anita Biguza, the director of operations in the Privy Council Office, which is the central public-service branch which supports the cabinet and the Prime Minister's Office.

"It is not clear how many other programs are being wound down as part of the government-wide plan. The government estimates that about 10% of Canada's greenhouse gases come from the agricultural sector.

"Last April, the government confirmed it was cancelling at least 15 climate-change programs, arguing they were ineffective. The two most high-profile programs were the One-Tonne Challenge that encouraged individual Canadians to conserve energy and the Energuide program that provided to incentives for Canadians to retrofit their houses.

"In May Finance Minister Jim Flaherty announced the first parts of the Conservative government's environment plan, including $370 million in tax credits for public-transit users.

"The government is also working on a plan where 5% of fuel sold within Canada will come from renewable sources such as ethanol.

"Internal e-mails at Natural Resources, which were recently released through an access to information request by the Liberal Party, reveal frustration and confusion among public servants working on climate change.

"The series of e-mails confirmed government officials were first asked to remove references to Kyoto from the government climate change-site in May and then to shut down the site, climatechange.gc.ca. entirely. In June.

"When the Liberals asked in June why the word Kyoto was being censored from government websites, Environment Minister Roma Ambrose dismissed the question as 'ridiculous.'

"Future spending estimates tabled by

each department on Sept. 26 show the extent to which the government is scaling back environmental funding.

"Agricultural Canada's spending in the environment will drop from $331 will drop from $331 in the current fiscal year to just $158.5 million in 2008-09.

"Meanwhile at Natural Resources Canada, which housed most of the government's climate change programs, the documents show a wide range of programs that will receive reduced funding or be cut off entirely.

"Overall, Natural Resources Canada estimates its total budget will drop from $1.47 billion this year to $1.04 billion two years from now and that the number of full-time employees in the department will drop from 4,456 to 4,154."

Wind-Power Playing Leap-Frog in the Developing World

From *The New York Times* (28/09, "The Ascent of Wind Power" by Keith Bradsher) we learn of some amazing progress in harnessing wind-power on strictly economic grounds – quite apart from its environmental virtues.

"Khori, India – Dilip Pantosh Patil uses an ox-drawn wooden plow to till the same land as his father, grandfather and great-grandfather. But now he has as new neighbour, a shiny white turbine taller than a 20-story building. Generating electricity at the edge of his bean field.

"Wind power may still have an image as something of a plaything of environmentalists more concerned with clean energy than saving money. But it is quickly emerging as a serious alternative not just in affluent areas of the world but in fast-growing countries like India and China that are avidly seeking new energy sources. And leading the charge here in west-central India is an unlikely champion, Suzlon Energy, a homegrown company.

"Suzlon already dominates the Indian market and is now expanding rapidly abroad, having erected factories in locations as far away as Pipestone, Minn., and Tianjin, China. Four-fifths of the orders in Suzlon's packed book now come from outside India.

"Its success suggests a way of serving expanding energy needs without relying quite so much on coal, the fastest growth fossil fuel but also the most polluting.

"Suzlon in many ways is an outgrowth of India's dysfunctional power-distribution system. Electricity boards owned by state governments charge industrial users more than twice as much for each kilowatt-hour as customers pay in the US – and they still suffer blackouts almost every day, especially in northern India. Subject to political pressures, the boards are often slow to collect payments from residential consumers and well-connected businesses, especially before elections. As a result they often lack the money to invest in new equipment.

"With natural gas prices climbing as well, wind turbines have become attractive to Indian business. The Essar Group of Mumbai, a big industrial conglomerate active in shipping, steel and construction, is now working on plans for a wind farm near Chennai, formerly Madras, after concluding that regulatory changes have made it financially attractive.

"The mechanisms didn't use to be there; now they are. The electricity boards know how to cost it, they know how to pay for it.

"'Roughly 70% of the demand for wind turbines in India comes from industrial users seeking alternatives to relying on the grid,' said Tulsi R. Tanti, Suzlon's managing director. The rest of the purchases are made by a small group of wealthy families for whom tax breaks for wind turbines are attractive. Wind turbines will remain competitive as long as the price of crude oil remains above $40 a barrel. With oil below that, wind energy may require subsidies, or possibly carbon-based taxes on oil and other fossil fuels."

Cultural vs. Environmental Shock

"To minimize land costs the wind farms are typically in rural areas, chosen for the strength of the wind there as well as for low land prices. But that can mean cultural shock.

"In this remote, hilly and tribal area 200 miles northeast of Mumbai, oxen remain at the center of farm life, and motorized vehicles are uncommon. More than 300 giant wind turbines with 110-foot blades snatch electricity from the air. But it has also struggled with the sporadic lawlessness that bedevils India.

"The copper or aluminum fetches as little as $1 from black-market scrap dealers. But each repair costs thousands of dollars in a country desperately short of electricity and technicians.

"Despite such problems, Suzlon has expanded rapidly as global demand for wind energy has taken off. Its sales and earnings tripled in the quarter ended June 30, from the equivalent of $41.6 million on sales of $203.4 million. The demand has particularly accelerated in India, where installations rose nearly 48% last year, and in China, where it rose 65%, from a lower base. Wind farms are starting do dot the coastline of east-central China, and the southern tip of India as well as scattered mesas and hills across central India and even Inner Mongolia.

"Still China accounted for 79% of coal consumption last year and India used 7% more, according to statistics from BP. China's target calls for expanding wind power almost as much as nuclear energy over the next 15 years. International experts are more skeptical that wind will displace coal to a considerable extent, saying that the sheer scale of energy demands suggests that coal burning will expand even faster than that of wind mills. Suzlon still sees plenty of opportunity in China and has decided to build some of its latest designs in China for the market there, despite the risk of having them copied by Chinese manufacturers.

"Chinese manufacturers already have the edge of price over imported equipment, according to Meiya Power of Hong Kong, which operates power plants across China and Asia. Mr. Tanti says rapid innovation and design changes would allow Suzlon to stay ahead of copycats. It would take about two to three years for rivals to clone Suzlon turbines because they use unique and proprietary parts. Suzlon has just completed a turbine blade factory in Minnesota, where it supplies turbines for a wind farm operated by the Edison Mission Group and Deere and Company. To reach the Suzlon wind farm here, the huge rotors travel by night on special trucks for the 300-mile ride from northwestern India on a succession of paved and dirt roads.

"Squatter huts have had to be removed along the way to allow the long trucks to turn. The truck crews also carry wooden poles to prop up electricity wires across the road to pass underneath."■

What is remarkable about this report is that it discloses more than a difference in its appraisal of the Kyoto protocol on reducing the greenhouse gases. There is what can only be described as a churlish disregard of the formalities associated with good, honest, and open intent in handling issues where an obviously disagreement exist. Decorous formalities are particularly important in a minority government that depends on transmitting signs of good faith essential for its survival. Why then are these meaningless courtesies that ease the conduct of human affairs during difficult moments so rudely disregarded.

The High Moral Cost of Cooking the Books

One contributing factor to this puzzle in human relations comes readily to mind. The growing gap in the living standards of the high executives particularly in the financial sector in contrast to the median earnings in the population at large has, after sex and major financial scandals, become the most popular item in the media these days. It is not that such huge gaps in the living standards between noble and peasant had not existed before. They certainly had in feudal Europe. But they could trace their origin to military conquest carried down over the centuries. What is peculiar about the social gap today between the very rich and the mass of people is that it has occurred as a reversal of a development in the opposite direction that followed the Great Depression and the Second World War. There was some difficulty in getting a nation that had gone through a decade of hunger and humiliation to go to war in defence of a system that had been so niggardly a provider for the common man. That problem had been handled by making very specific commitments to the nation sacrificing both in the front lines and in production at home. Promises were made that the world arising from the sacrifices of the combat would never again inflict on the masses of citizens the indignities of the Depression. However, today the gap between the earnings even of professionals and industrialists and leading financial executives has widened so immensely, that it stuns the average citizen.

The fact is that the Great Depression had witnessed what was practically the surrender of the bankers most of whom had lost the courage to make loans, while business had lost the courage to borrow. It was largely into the territory thus left empty that governments stepped in to fill a vacuum. The postwar, it was vowed, was to be a world of full employment and more equal educational opportunities. The Roosevelt *Bank Act* of 1933 had thrown up walls separating the banks from the other financial pillars – on good enough grounds. For each of these non-banking pillars maintained its own liquidity pool to serve the needs of its own industry. Allow the banks access to these pools and deregulate them for the purpose and inevitably the banks would apply their multiplier to these extended money bases.

A Financial Tower of Babel Big Enough to Challenge Governments

This created a many-storeyed financial Babel powerful enough to defy government. Within the strict confines of banking imposed on them during the war, the banks had recuperated and began longing after the fleshpots of the 1920s. They plotted their comeback, which, given the new political topography, had to be organized outside government and to a certain extent against government. In his autography, President Harry Truman recounts how he learned to his surprise in 1951 that his Treasury that had been negotiating what he as President had been given to understand was an adjustment of the wartime peg of interest rates to the inflation let loose by the end of US price controls at the beginning of the Korean War! It was only when it was too late that he learned that his Treasury had double-crossed him to do away with the interest-rate peg altogether. That was the first step on the long trail of the banks' comeback to where the Great crash had interrupted their heyday in 1929.

A suitable bunker in which the comeback of the banks could be planned and its direction directed had been providentially provided In 1929 the Bank for International Settlements had been set up as a purely technical institution to handle the syndication of German World War 1 reparations into hard currencies. But the Wall Street Crash had interrupted the project and the BIS lingered on with little on its platter. When Hitler's troops entered Prague, it made haste to surrender to the Nazis the gold reserves that the Prague government had left with it. It was because of that at Bretton Woods, in 1994,the Norwegian government with the backing of other governments-in-exile proposed Resolution Five for the dissolution of the BIS at the earliest method. As a result, BIS cultivated a low profile.

That low profile, however, recommended it superbly as semi-underground bunker for plotting the banks' comeback. Elected government representatives were not encouraged to attend its regular sessions. It was in Basel that zero inflation, the independence of central banks from their governments even when they owned all their shares was established as pious monetary doctrine. When the deregulated banks lost much of their capital in real estate and other ventures incompatible with banking, the bail out of the banks was largely planned at Basel in the BIS offices.

Semi-underground Bunker for the Banks' Comeback

First in 1988 came the Risk-Based requirements that declared the debt of advanced countries risk-free and thus suitable for banks to acquire with no money down. In that way they were allowed to reconstitute their lost capital by loading up with government bonds that we shifted massively from the central banks where the interest paid by the government on the bonds came back to it substantially, to the commercial banks where the interest stayed with the banks that held them. On top of that the various central banks throughout the world were encouraged to discontinue the statutory reserves that had required the banks to deposit a part of the deposits they received from the public with the banks. This had provided an alternative to the benchmark interest with which the central bank could change the pulse of the economy. If it raised the statutory reserve that had to be left with the central bank, the banks had less of their deposits to serve them as money base for the bank loans they created; if they wished to stimulate an inactive economy they need only lower the statutory reserve and that would increase the banks' capacity for making loans. Most important was the alternative that these reserves provided to interest rates.

What BIS and the worlds central banks overlooked in their concern that the world monetary system would collapse in the 1980s was this: if the banks load up with government bonds with no money down and then the BIS "to lick inflation" raises interest rates to the skies, the market value of the pre-existent bonds with lower coupons takes a dive. That brought down the Mexican peso in 1994, and almost crashed the world financial system. Only a special fund of a then record level of $51 billion raised on the initiative of President Bill Clinton avoided even greater disasters. And

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Was It for This that Our Ancestors Crossed the Great Waters?

Financial Times of London analysts (2/11) report that that social mobility today is greater in Europe than in America. "Jack Drake understand better than most Americans how strongly the US economy has performed over recent years. His job with a media company involves transcribing conference calls hosted by public companies to deliver financial information to analysts and investors.

"'Almost every day, I listen to chief executives explaining how well their companies are doing,' he says. But Mr. Drake, 42, complains that the soaring corporate profits and robust growth aren't reflected in his own financial circumstances. His $47,000 has barely moved for five years. 'Health care costs are up. Energy is up. But my income is standing still.'

"Mr. Drake is among millions of educated middle-class Americans seeing their pay stagnate, and blaming that on technology and globalization. 'It would be hard outsourcing my job, because there is much specialized knowledge and business jargon involved. But outsourcing is used as an unspoken threat to keep wages down,' he remarks.

"Since 2000 there has been a striking disparity between growth in productivity and gross domestic product and growth in the wages of the average American [and we might add, of Canadians as well]. Economists call this phenomenon median wage stagnation. Unlike mean or average wages, median wages are not pulled upwards by rapid gains at the top. As the joke goes: Bill Gates walks into a bar and, on average, everyone in he room becomes a millionaire. But the median does not change.

"Between 2000 and 2005, the US economy grew by 12% in real terms. Productivity measured by output per hour worked in the business sector, rose 17%. Over the same period the wage the average American take-home pay rose only 3% in inflation-adjusted terms. That compares with a 12% gain in the previous five years, Real family income fell every year from 2000 to 2004. It increased last year, but is still lower than in 2000.

"In his first speech as Treasury Secretary, Hank Paulson admitted that median wage stagnation was a problem, saying that 'amid this country's strong economic expansion, many Americans are simply not feeling the benefits.'

"Ed Lazear, current chairman of the Bush Council of Economic Advisers, says it is common for productivity and real wages to diverge in the first half of a business cycle. 'Wage growth sometimes lags productivity growth, especially coming out of recessions. Then as the cycle matures, real wages begin to catch up with productivity.'

"'What is different this time,' he says, 'is that unforeseen increases in the price of oil from 2003 onwards robbed real wage gains, based on the expected rate of inflation.'"

But that is not the whole story. It is necessary to break down the phenomenon into its component factors.

The Growing Gap between the High and the Median

"'Anything that just looks at cash wages is incomplete,' says Greg Mankiw, a Harvard professor and former chairman of the Bush Council of Economic Advisers. 'On the other hand, no question, there is increasing inequality between high and median income people – no adjusting or compensation would change that.'

"Another partial explanation is that prices of consumer goods have risen faster than those of domestically produced goods in general, so a given increase in output productivity buys fewer consumer goods.

"Mr. Jared Bernstein and Larry Mishel, of the Economic Policy Institute, estimate that these two factors account for a little less than half of the total divergence between productivity and real medium wages since 2000. The other half reflects growing inequality among wage earners, and a shift in the share of national income captured by labour and capital.

"In the 1980s, the story of wage inequality in the US was one of the poor falling further and further behind the middle class, while the rich pulled ahead. Now the poor are keeping up with the middle, but the rich keep pulling away.

"Thomas Picketty, a professor Paris Jourdain Sciences Économiques and Emmanuel Saez, a professor at Berkeley, estimate that the share of total income captured by the top hundredth of the US doubled from 8% in 1980 to 16% in 2004. In fact the gap between the middle and the upper income brackets grew more rapidly in the late 1990s under Mr. Clinton than it has under Mr. Bush. The difference is that in the late 1990s the rising tide in the labour market was so strong that it lifted most boats, even if some rose a lot higher than others. In the early 2000s some remained stranded.

"Mr. Mankiw says: 'Nothing special happened since 2000. Increasing inequality happened some time in the 1970s. The late 1990s was the "exceptional period" with real wage gains across the income spectrum, but only because the economy 'was going through a bubble.' This was something that could not be sustained.

"A fundamental feature of the late 1990 economy was a dramatic shift in the share of the national income going to labour, which surged from 56.7% in 1997 to 58.2 in 2000 – and then fell dramatically from 2001 onwards, reaching a low of 56.8% in 2005. Meanwhile, profits soared, reaching 13.6% of GDP in the second quarter of 2006 – close to an all-time high.

"Mr. Lazear argues that the US is today where it was in 1997 – when the labour/capital share began to swing back towards workers. Nominal wage growth has accelerated this year – certainly at the average level, probably at the median too – with an extra boost to real incomes recently from falling energy prices. 'We have seen the turnaround,' he says."

The Gap between the Sure and the Seemly

"Others are not so sure, particularly since unemployment is widely expected to rise from its low of 4.6 %, reducing pressure on companies to compete for workers with pay rises.

"It is possible that over the next few years labour as a whole will capture a bigger share of income from corporate profits. It is also possible that it will not, since globalization may have permanently changed the relative bargaining power of capital and labour in the industrialized world. Increased global competition may have eaten away the economic 'rents,' or excess returns, earned by US manufacturing workers, Glenn Hubbard, dean of Columbia business school and another chairman of the Bush Council of

Economic Advisers, says most explanations for this revolve around the familiar culprits – globalization and technology."

[May we pause at this point to express our tribute to such belated rediscovery that the world indeed is round, and that there is room on it for antipodeans who walk on their heads? Turning good old Henry George around from his view of ground rent from a parasitic free ride on the efforts and inventions of others, and sticking it on those who do the skilled work on the planet, is in a certain sense an achievement.]

"Meanwhile, the growth of global corporations and markets allows 'superstars' – sometimes in business, finance, sports, law or entertainment – to apply their talents across a much bigger basis, increasing the economic return to their skills.

"The most potent force, though, may be technology rather than globalization – though the two are inextricably linked. Larry Katz, a Harvard Professor who worked in the Clinton administration, says information technology is essentially 'complementary to workers at the top, a substitute for workers in the middle' and of minimal relevance to those to those at the bottom of the income scale."

Ever Harder to Grow Rich

"If 1,000 people were chosen at random in the US, the UK, and France in 1963, the richest person would have commanded 2% of the combined income – 20 times more than if all wages were equal. At the end of the 1990s, the share of the richest person had grown to 6% of the total income in the US and 3% in the UK, but was still 2% in France. This suggests strongly that the other countries have by no means shared the US experience in the richest expropriating the bulk of rising prosperity.

"These estimates are just snapshots of incomes. So perhaps a better barometer of a society's earnings is whether people on lower incomes have a decent chance of becoming rich. Mark Pearson of the Organisation for Economic Co-operation and Development suggests the answer is not encouraging for the US. In studies of intergovernmental income and earnings, countries such as the US with high income inequality tend to have less social mobility than countries with greater equality. The son of a rich man is much more likely to be rich than the son of a rich Swede. The same is true for a poor American versus a poor Swede.

"High-earning parents in the US, the UK and Nordic countries are all fairly good at ensuring their children also become rich. In the US and to lesser degree the UK, sons of poor fathers are disproportionately likely to be poor. But in Nordic countries this is not true. The sons of the poor are no less likely to succeed than those of middle-income fathers. So while the poor have a very realistic expectation of becoming middle-class in Scandinavia, it is an exception to the rule in the US. Median wage stagnation in the US threatens to expose the truth. To the extent that Americans believe rigidities in their society impede success, unhappiness is likely."

Turn, turn in your graves, Founding Fathers of the Republic.

William Krehm

Significant Crossings of the Line for the Post-Bush Era

When official news channels lose credibility, the desire spreads to seek a believable alternative yonside the official line. Too often this arrives designed to earn its own keep and better.

And the intertwining of means and purposes in this highly commercial cut of history makes it necessary to track the new information source, and exercise our own judgment that on so many crucial occasions has been so badly abused. It might be considered as one of the many invoices being presented to the Western world for having so long taken seriously the unspeakable rationings of the Bush regime.

To meet just such challenges on the most modest non-commercial basis – COMER has been dedicated for some decades. We cherish reminding the world of the long line of distinguished economists whose names have long been forgotten on the official academic registers, but who have become timely because of these new developments.

From *The New York Times* (13/11, "A New Al Jazeera With a Global Focus" by Hassan M. Fattah) we have the following: "Dubai – Al Jazeera, the Arab news channel that began a decade ago as an upstart, has become a thorn in the side of every dictator in the region as well as of the Bush administration.

"Critics call it radical. Its admirers lionize it. And the network continues to battle accusations that it is sympathetic to Al Quaeda – and its offices have been shut in almost every major Arab country at some point, and bombed by American aircraft in two wars.

"Now, Al Jazeera's journalists are working to transform the channel into a conglomerate with global reach.

"By the end of the year Al Jazeera will have new channels in Arabic and English, a pan-Arabic newspaper, Web sites and blogs, sports and children's outlets, and even a channel modeled after C-Span.

"The network (which turned 10 on Nov. 11) is looking to extend its sphere of influence beyond the Arab world. On Wednesday it will start the English-language Al Jazeera International, which will go on the air from Asia to the US.

"The channel will broadcast from network hubs in Qatar, London, Washington and Kuala Lumpur, Malaysia, offering news, talk and documentaries that its managing director, Nigel Parsons, said would have a decidedly different tone than on established Western channels.

"In effect Al Jazeera International intends to become for the developing world what Al Jazeera became to the Arab world: a champion of forgotten causes, a news organization willing to take the contrarian view and to risk being controversial.

"'We want to cover the untold stories' Mr. Parsons said by telephone from Qatar. 'We would be anchored in the Middle East, but we intend to cover the developing world fully and to risk being controversial. We will use Asian reporters to cover Asia and Africans to talk about Africa, rather than have instant experts land there and tell us the story.'

"The channel has signed prominent journalists, including David Frost, the former BBC correspondent, Rageh Omar, and a onetime CNN anchor, Riz Khan, as well as numbers of producers and reporters from Western networks with a decidedly international look. We will show the ugly side of conflict. 'War has been too sanitized in the media.'

"Mr. Parsons and others have stressed that viewers should not expect to see the Al Jazeera that the Arab world watches daily. Al Jazeera International has separate crews and editors working completely independent of the original network.

"Al Jazeera's international offshoot is not under pressure to turn a profit anytime

soon, in part because of its endowment from the emir of Qatar, Sheik Hamad bin Khalifa al-Thani, who has underscored his longtime commitment to Al Jazeera despite pressure from many governments.

"The Arab channel, largely backed out of the advertising market by Saudi businesses, who account for most ads in the region, has yet to turn a profit. Nor is Mr. Parsons necessarily focused on reaching American viewers. Mr. Parsons said, 'This is a world increasingly skeptical of American intentions and frustrated with American foreign policy.'

Money-making Is the Brooklyn Bridge of Great Cross-overs

"Mexico City, 12/11 – Remember Ross Perot's 'giant sucking sound'?

"The Texan billionaire and onetime presidential candidate railed against the North American Free Trade Agreement in the early 1990, arguing that it would create 'a giant sucking sound' of good American jobs pulled to low-wage Mexico.

"But things change. The Perot Systems Corporation, managing information technology for companies, is setting up technology center in Guadalajara where it expects to employ 270 engineers by the middle of next year.

"Neither Mr. Perot who is now chairman emeritus of the company he founded in 1988, nor his son Ross Jr., the company's chairman, were on hand for the announcement in Guadalajara, Thursday. But a company spokesman, Joe MacNamara, said that lower pay for engineers was only one of several reasons Perot Systems decided to setup in Mexico.

"The company is also looking for other places to set up in Mexico, the company spokesman Joe MacNamara said. 'There's room for growth.'

"The Perots are hardly bucking the trend. The information technology industry has steadily grown offshore. Perot Systems, based in Plano, Texas, employs 20,000 people in more than 20 countries, 6,000 of them in India alone. The company will also announce a new operation in the Philippines and one in Kentucky soon." For several years now Mexico has tried to carve out a niche as a low-cost software developer in an effort to win a fraction of the business that now goes to India. But so far Mexico has failed to catch on, despite its growing pool of bilingual engineers and the advantage of being in the same time zones as the United States.

Thrift, Thrift Will Cuba's Funeral Baked Meats Coldly Furnish Forth the Marriage Tables?

The Wall Street Journal (11/15, "Cuba's Military Puts Business on Front Lines" by Jose de Cordoba) informs us: "At the height of the Cold War, Cuba's soldiers became a legend on the island when they punched

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Developing *continued from page 13*

from that close call with world-wide disaster, the US Secretary of the Treasury. Robert Rubin, saved the day by introducing accrual accountancy (also known as capital budgetting). Up to then when a government built a road, a bridge, a school, or bought equipment that would last for years, they nonetheless wrote off the investment in a single year and then carried the fully depreciated value on its books at a token dollar.

Opening the Doors to Cushy Privatization Deals

This opened the door to all sort of cushy deals privatizing capital assets that had been already written off in a single year, were sold to interests for a song, providing a "capital gain" which could be presented as a prudent reduction of the debt. That once done that asset could be listed on the stock market at its true value, and then the public would start paying in user fees what they had already paid for in taxation.

That of course was not called "accrual accountancy" but "savings" – which of course it was not. Savings implies cash or near-cash, and these discovered assets were in bricks mortar, concrete and steel. By carrying this process back into the late 1950s, Washington recovered a $1.3 trillion dollars of non-recorded assests, which raised the credit rating agencies' grading of the creditworthiness of government credit drastically and brought down interest rates, giving Clinton his second term, and the stock market its high-tech boom that led to the 2000 bust.

But note well, the accrual accountancy brought in still took no step to recognize government's huge investment in human capital – education, health and social services. What is particularly interesting in such human investment is that its rate of depreciation is very slow if not actually negative. For children of educated healthy people tend to be healthier and better educated. Without a vastly improved educational system we could never have trained our population even as consumers, let alone producers, in this electronic age.

The arbitrary manner in which the Harper government is playing with the commitments of our government to the Kyoto protocol, should be a warning. It reminds us of the unscrupulous way in which the banks clawed their way back approximately to their status of 1929 that gave us the Great Depression and the Second World War. There is only one way of reducing the likelihood of our repeating the tragic blunders of our past record – by studying our history instead of suppressing it.

Everything that was in the *Bank of Canada Act* that made possible financing of capital projects of the Federal and provincial governments through the Bank of Canada, with almost every dollar returning to the one shareholder of the BoC as dividends resulting in a near-interest free loan for essential capital purposes. The matter of the statutory reserves which were phased out were in the *Bank Act*, not the *Bank of Canada Act*. That the *Bank of Canada Act* remains intact was partly miracle, partly farce.

Brian Mulroney as PM wanted to put two provisions in the Canadian Constitution that was being drafted in 1982 – one was the independence of the Bank of Canada from the government – in spite of all the sacred rights of ownership. The other was zero inflation. But his own caucus on the Commons Finance Committee defeated his proposal. Accordingly he decided not to mess with the *Bank of Canada Act*. That makes it all the more important to ask Mr. Harper that he respect the provisions still in the *Bank of Canada Act* that would permit the federal government, and by arrangement with the Provinces and the federal government, the municipalities be given access to financing of essential capital projects that were downloaded by the federal government to the provinces who passed on the compliment to the municipalities. It is a monstrous situation where the fundamental monetary legislation of a country is ignored by the central bank. Surely this is a matter on which the Courts of this great land must declare themselves.

Starting at that basic level will help our new Prime Minister cultivate a code of manners in better keeping with his high office. By implementing the provisions of the Bank of Canada, Mr. Harper will be able tap a natural source for environmental safeguard and restoration that will help stabilize the future of our land.

William Krehm

through enemy lines defeating South Africa's army in Angola. Today Cuban generals are applying capitalist tactics to try to improve bottom lines in businesses that range from growing beans to running hotels and airlines.

"Cuba's Revolutionary Armed Forces rent rooms to tourists through Gaviota SA, the island's fastest growing hotel conglomerate. They sell premium cigars, peddle consumer goods through an island-wide retail chain and serve lobster dinners at Divina Postora restaurant in Havana's landmark Morro Castle. The military also has a say in allotting nickel mines and leasing offshore lots for oil exploration. The University of Miami Institute for Cuban and Cuban American studies estimates that soldiers control more than 60% of the island's economy.

"The military's economic role will likely become even more critical after the death of Cuba's ailing 80-year-old leader, Fidel Castro who is widely believed to be dying of cancer. Although Mr. Castro has steadily opposed economic reforms during his 47-year-old communist regime, his younger brother and anointed successor, Raul, has shown a deep interest in free-market experiments in the past. As defence minister since the 1959 revolution, he has frequently looked to the military as his laboratory.

"[Thus] Cuba could be poised to follow what the islanders call 'the Chinese model' of liberalization. This means carefully experimenting with market incentives in one of the few remaining Communist economies. It's far from clear that a Raul Castro government could accomplish a Chinese style transformation. China is not located 90 miles from the US and a wealthy US community of exiles looking to reshape their home country along American lines. But the seeds of economic reform may be planted more firmly than many expect. Raul has travelled to China a number of times to study Beijing's economic policies and in 2002 he invited the leading economic adviser to the Chinese premier Zhu Rongj to give a series of lectures in Cuba. In the 1990s Raul sent officers, who had previously trained at prestigious Soviet military schools, to learn hotel management in Spain, accounting in Europe and Latin America, Asia and Canada.

"Raul, now 75, also adopted capitalist style accounting and management incentives to run army-run factories that made everything from uniform to bullets. In some cases workers have been given incentive pay."■

Must We Depend on the US Prosecutors to Keep Track of What Our Banks are Doing with their Bailout Money?

We have had not infrequent occasion to point out that we have depended on the US authorities for information on how our banks were making use of the bail-out funds lavished upon them at our tax-payers' expense. Thus the CBIC settled out of court with Enron itself for the partnership scam that it had actually designed and financed with the help of two other of our really big banks. This destroys the image with which we flatter ourselves as a land of pristine virtues in contrast with our southern neighbours where gangs of white collar and black-shirted gangsters roam.

But certainly the remarks of the deputy director of enforcement of the US Securities and Exchange Commission. Walter Ricciardi, at a conference of our top securities regulators left no room for doubt. He was here for a purpose hardly flattering for Canada – to teach our regulators the elements of law-enforcement applied to white-collar crime.

In the words of *The Globe and Mail* (15/11, "If you want to net the bad guys, make it quick, regulators told" by Janet McFarland): "It should have made Canada's top securities regulators gulp." They had plenty not only to gulp about but to choke over. Canada's record of pursuing crooks undoubtedly draws its inspiration from the conspiratorial way in which it has repeatedly bailed out our banks and other financial institutions. That makes them too often associates in hushing up the transfer of major portions of the national income to the ever more deregulated financial community. It establishes a fund of collusion based on key information hidden from the public that comes to live a life of its own. It rules our land more than the elected governments, who – no matter what colours they fly during election campaigns – end up taking instructions from a bureaucracy that was never elected or ever had to account to the electorate.

"But let us listen to our American visitor who was certainly here for professional reasons: 'There's a mental checklist that goes on in the heads of these fraudsters. What is the likelihood I'll be detected, and if I am detected, what might my penalty be, and how quickly is it likely to come?' Mr. Ricciardi said.

"So you need a penalty sufficient to deter that kind of conduct, and it has to be swift, it has to be pretty severe, or these types will do that mental calculus and say even if I get caught, it won't be that severe so I'll take the risk."

Mr. Ricciardi wasn't commenting on Canada's track record on fighting securities crime, but his remarks had to hit home to a roomful of Canadian regulators and securities lawyers attending the Ontario Securities Commission's annual Dialogue with the OSC Conference.

"During a panel discussion Friday morning some of Canada's leading law enforcement people conceded investigations move too slowly through the court system after the charges are laid. The trial of former Bre-X Minerals Ltd., chief geologist, John Felderhof, wrapped up this summer, nine years after the gold company was exposed as a fraud, and a ruling is not expected until next February. The case against former Livent executives still hasn't gone to trial, even though the company collapsed in 1998.

"And the RCMP have not yet announced any conclusions to their high-profile investigations, including Nortel Networks Corp., and Royal Group Technologies Ltd.

"Moreover, a recent report revealed the RCMP's specialized white-collar crime unit is not taking on new cases. A background paper released last month by the Task Force to Modernize Securities Legislations in Canada said the Integrated Market Enforcement Team (IMERT) program is investigating eight cases, so cannot take on any others."

RCMP Commissioner Giuliano Zaccardelli summed up the Canadian situation as "process constipation," arguing these are far too many delays that hinder the police.

"According to OSC enforcement director Mike Watson, delay may be the worst enemy of prosecutors. 'We're in an odd situation where we have allowed the system

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Reserve Requirements in the Eurosystem

From *Central Banking Systems Compared – The ECB, the pre-euro Bundesbank, and the Federal Reserve System*," by Emmanuel Apel, Routledge, London, UK, 2003, we have invaluable information on how some key central banks of the world operate:

"The Governing Council of the European Central Bank (ECB) decided to impose reserve requirements on credit institutions established within the eurozone, In recent years, many central banks have eliminated required reserves, such as the pre-euro Banque Nationale de Belgique, Danmarks Nationalbank, Sveriges Riksbank, the Bank of England and the Bank of Canada. Prior to their integration in the Eurosystem in 1999, both Deutsche Bundesbank and the Banque de France still maintained required reserve ratios, although the ratios had been declining over time to reduce the incentives for financial disintermediation (e.g., banks becoming insurance companies [they simply insure the safety of deposits received]) and delocalization (a venue change) towards jurisdictions with no reserve requirements. By mid-1995 to the end of 1998, the Bundesbank's minimum required reserve ratios for sight liabilities and for savings deposits were 2% and 1.5% respectively – a reduction from an average of 11% on sight deposits, 4.95% on time deposits and 4.15% on savings deposits at the beginning of the 1990s (Deutsche Bundesbank 1996:58). The Board of Governors of the [US] Federal Reserve System still maintains required reserve ratios on transaction deposits of member banks and, since 1980 has extended the requirement to all depository institutions."

Reducing Reserves to a Hand-maiden of Interest Rates

"Like the pre-euro Bundesbank, the ECB Governing Council sees a minimum required reserve system as a way of contributing to the stabilization of short-term interest rates, therefore reducing the need for frequent central bank interventions to fine-tune short-term interest rates. The averaging provision of the minimum reserve requirements described in the next section aims to contribute to the stabilization of money market interest-rates by giving institutions an incentive to smooth the effects of temporary liquidity fluctuations. [N.B. This understates the original purpose of reserve requirements by subordinating them to smoothing out the violent effects of the benchmark interest-rate as the main enforcer of a stable price level.] For instance, if banks find themselves with excess liquidity, they will absorb it as reserves to be used to offset a shortage of reserves on some other days during the maintenance period.

"A eurozone credit institution must hold a minimum of reserve equal to 2% of its reserve base, less a lump-sum allowance of €100,000 of reserves, which effectively excludes the very smallest institutions from the reserve obligation. Reserves must be held at the NCB (National Central Bank) in the country where the institution is located, even if it is incorporated elsewhere (thus there is no cross-country pooling of reserves). For example, the German branch of a French bank and a German branch of a US bank must both hold reserves with the Bundesbank. The 'reserve bank' comprises all deposits and debt securities issued with a maturity of up to two years, Including foreign-currency denominated liabilities but excluding any balances owed to other institutions subject to eurozone minimum reserves."

Enter Bank Seignorage

And here comes a revealing passage that indicates that the whole purpose of statutory reserves has changed from an alternative to the benchmark interest rates for regulating the money supply to avoid "inflation." Even where statutory reserves have not been wholly abolished, their function has been down-graded from an alternative to the "one blunt tool" of the benchmark bank rate, to a handmaiden that irons out the bumps and creases to make the interest tool more acceptable rather than as an alternative for controlling the economy.

"Like the pre-euro Bundesbank, the ECB Governing Council sees a minimum required reserve system – in which the central banks rather than receiving the statutory deposits from the banks on an interest-free basis, actually pays the banks what has come to be known as 'bank seigniorage,' suggesting that the banks have in fact come to power as heirs of former sovereigns. This blunts the capacity of the statutory reserve system in sharing or replacing the benchmark interest rate for flattening out our price indexes, and leaves only what has come to be known as the 'corridor' – the differential rate between the going benchmark rate and the 'banks' seigniorage.' What has been overlooked, though more likely left unmentioned because it serves the central banks' ultimate purpose in supporting the takeover of much of the economy by the banks, is that the 'corridor' has seriously reduced the leverage of the statutory reserves as a means of expanding their net effect in reviving a depressed economy by lowering the net difference between what the banks could earn from a lesser statutory reserve due to the reduction of their net return via the 'corridor' to which the 'bank seigniorage' has now been deducted.

"The leverage of the statutory reserve as an alternative to raising the benchmark interest rate has been cut drastically, and a shift of the reserve ratio will have to be more drastic to attain a 'corridor' effect equal to the former total increase or decrease of the reserve itself. Thus while the benchmark interest rate is beautified, the ability of the statutory reserve to meet its original purpose has been crippled, and indeed, buried beyond official memory.

"It is worth noting that 'the pre-euro Bundesbank was the European national central bank that had enjoyed *de jure* and *de facto* the greatest degree of institutional independence' from the government and the legislature In exercising its primary monetary policy functions to achieve and maintain its statutory objective of 'safeguarding the currency,' the Bundesbank could not receive instructions from either the German Federal Cabinet or the legislature (Bundestag or Bundesrate). While there was no formal channel for the exchange of information between the Bundesbank and the German federal parliament, which meant that Bundesbank officials did not have to appear before the German parliament to explain or engage in a dialogue about, the conduct of monetary policy. Members of the Federal Cabinet, generally the Finance Minister, were entitled to attend, without having the right to vote, the meetings of the Council, and could even propose motions. Similarly, the Federal Cabinet could invite the President of the Bundesbank to attend its deliberations to comment on issues that may have had indirect effects on monetary policy, as long as such support was not in conflict with the Bundesbank's primary ob-

jective of 'safeguarding the currency.'

"Without prejudice to the performance of its duties [such as safeguarding the currency], the Deutsche Bundesbank is required to support the general economic policy of the Federal Cabinet (Article 12 of the *Bundesbank Act* of 1957)" [pages 39 and 87].

Contrast that with subsection 14(2) of the *Bank of Canada Act* that reads:

"If, notwithstanding the consultations provided for in subsection 1, there should emerge a difference of opinion between the Minister and the Bank 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 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."

That could hardly be clearer. What is at issue, be it noted, is in whose hands rests the power over the financial system. Canadians should learn to make use of this uniquely rare legislative gem, the *Bank of Canada Act*, that, though violated in spirit and practice, has never been repealed.

William Krehm

The Crucial Aspect of the Income Trust Imbrogio has Escaped our Analysts

The Wall Street Journal (1/11, "Canada to Seek Tax on Income Tax Distribution" by Max Heinzl) takes a direct, uncomplicated view of what in the Canadian press and Parliament seems as hopelessly entangled as the quest for the Holy Grail: "Ottawa – Canadian Finance Minister Jim Flaherty said the government will propose the introduction of a tax next year on distributions that might stem the flood of publicly trade companies converting to that corporate structure.

"Mr. Flaherty said companies that already have adopted the structure would be allowed a four-year grace period before the tax applies to them. But the tax would take effect in 2007 for companies that have adopted the structure would be allowed a four-year grace period before the tax applies to them. But the tax would take effect in 2007 for companies that haven't yet converted. He didn't indicate the rate of the tax.

"Income trusts avoid paying corporate taxes by distributing much of their profit in dividend-like payments to investors, known as unit-holders instead of shareholders.

"Mr. Flaherty said the trust structure is bad for Canada in the long run because it discourages reinvestment and creates tax imbalances. 'Canada has been out of step with other countries that discouraged such corporate structures,' he said.

"Almost 250 Canadian companies have converted to trusts, most in the last five years, commanding a total of about 200 billion Canadian dollars, or roughly US 200 B in market value. But in recent months many have found their payouts to be unsustainable and have been forced to cut their distributions sending unit prices sinking.

"Recently two of Canada's biggest telecommunications companies, Telus Corp. and BCE Inc. won applause from their shareholders when they announced plans to convert to trusts. But the announcements also stirred public policy debate. Including the planned Telus and BCE conversions, the annual loss of tax revenue according to an estimate by University of Toronto professor Jack Mintz may reach C$1 bullion. An association of income trusts contends there is no significant impact on tax revenue from trust conversions."

That, however, is stretching the facts beyond the breaking point. Once relieved of the payment of corporation taxes before it reaches them, the unit-holders have the whole world of gambles and tax havens at their disposal before the taxpayer can catch up with them again. That is indeed the purpose of the income trust conversions.

What is missing in all this discussion is the historic roots of the income-trust conversions. For that we would have to go back to the development of English major cities, in particular the City of London. The ownership of city land goes back to the Norman Conquest. The nobility rarely sold their urban land holdings, because they knew that huddling around the royal court, urban centers with all their amenities developed, and the land where all this happened became ever more valuable. At most they leased the lots at times for as long as for a century or 99 years, and in that way whatever improvements or mere convenience of location close to the founts of influence, pushed up the price of sites.

However, the case of an intercommunication company is the exact opposite of that.

Not only is there no ever-swelling stream of unearned income coming to the unit-holders from the efforts of others, but the stream of revenue can disappear at its source for anyone. Only if further capital plus good luck may turn up new sources of passive, unearned income for the "unit holders." A touch of history, as in so many cases can shed light on whether immunity from taxes makes sense or is nothing but class greed. Most absurd is the protest coming out of the oil patch on the matter. For example *The Globe and Mail* (2/11, "Ottawa's tax surprises sends investment bankers scrambling, investors fleeing, stock prices plunging" by Steven and Leonard Zehr). The stream of revenue there is limited in time, is creating havoc with environment and human and other forms of life. And is not only in itself threatened by puts a question mark over the basic technologies of oil companies."

Note how conscious some of the brighter minds of the business world rely on the real historical precedents of the classical historic roots of ground rents, the grand daddy of the whole progeny of bastard offspring that it has produced. To begin with the most successful of all trust funds has been the REITs because they are in fact based on a continuation of the English ground rent model. Directing pension funds to income trusts based on highly perishable revenue streams is in itself a confidence game and should be stopped rather than rewarded.

On the other hand note how clearly Isadore Sharp, he creator of the uniquely successful Four Seasons Hotel Chain put his finger on a real source of unearned revenue that may accrue to an initiative that influences the worth of the entire district as one of their luxury hotels grew up. Thus in *The Globe and Mail* (07/11, "Sharpe to Remain Chairman, CEO"): "Indeed, one source familiar with negotiations said a force driving the sale was Mr. Sharp's growing conviction that Four Seasons could profit by acquiring valuable property surrounding many of its hotels. The real estate ambitions mark a reversal of Four Seasons' long standing strategy to manage hotels rather than own the real estate. [That of course was due to the higher interest that led Four Seasons to shut down and sell their Calgary

Hotel when the oil boom of the 1970s tanked.] Mr. Sharp 'felt that he didn't have the flexibility as a public company to attract blue-chip clients to adjacent buildings. Opportunities were being lost and he wanted to do something,' one person involved in the discussions said."

Of course, the government makes even greater contributions to the infrastructures that create the possibility of Four Seasons' elegances. Decades ago I suggested a plan whereby governments which at all levels have advance knowledge of, say, a subway being considered for a certain route It could acquire strategic lots near future subway stations, and instead of letting speculators rake in the secondary benefits of such transport facilities. By secretly purchasing corner lots and leasing them out for 99 year leases or whatever, it could keep much of unearned rental income out of the future rents of such properties, and out of taxes. Inevitably, the proposal though presented to the federal financial committee by the late John Hotson, was never even seriously considered. That would have provided income trusts of unearned rents in the public interest rather than of speculators.

And yet it is to the historical precedent the London land leases that we must look to grasp what the current debate on income trust is or should be based.

History is the great and ultimate guide. Hence the fatal effects when it come to be disregarded.

William Krehm

Prosectors *continued from page 17*

to develop an infinite number of tools for defence counsel to delay,' Mr. Watson said.

"One new tactic, he said, is that OSC requests for documents are met with demands from lawyers that every page be reviewed to ensure none are subject to lawyer-client privilege. He said it can take eight months for a lawyer to look at 100,000 pages of correspondence between executives before passing them on to OSC. And meanwhile investigations languish.

"Regulators were also critical of their own efforts, Jean St-Gelais, the head of Quebec's financial services regulator, the Autorité des marchés financiers, said there is still a lack of cooperation between various law enforcement bodies such as the RCMP and securities commissions.

"He said it isn't because commissions 'want to protect our turf,' but because they don't trust other enforcement bodies like the RCMP or the Sûreté du Québec will get he job done properly if they hand over their cases.

"Mr. Zaccardelli said that the lack of will to co-operate often comes from higher-ups in organizations, while many front-line investigators are generally happy to coordinate their efforts."

Our Government as the Greatest of Scofflaws

However, white-collar crime, to attract so much attention cannot be put down to individual initiatives. It calls for a degree of mockery of the law of the land to the point of becoming institutionalized. And our lawyers, whether defending the alleged culprits or acting for the prosecution are above all professional scholars of legislation.

It is enough for a municipality to address a letter to any Minister of any level of government over the past 40 or so year s asking for his government to guarantee the application of the municipality for the most urgent capital improvement – the building of an adequate waterworks or school, or hospital, to receive the stock reply, that the Bank of Canada does not provide such loans. If it addresses the request direct to the Bank of Canada, he will receive the same reply directly. Yet almost a page of the *Bank of Canada Act* still in force explains in detail how the government may make funded loans and unfunded loans to every level of government, and even to corporations when guaranteed by the federal government or any province.

The case of funded debt – formally organized with a date of maturity when it must be repaid, and what rates of interest, and so forth.

The case of funded debt, i.e., organized as a bond issue, is to be found in subsection 18(1) of the Act: "The Bank may buy and sell securities issued or guaranteed by Canada or any province."

"Buy and sell" implies "hold" as well. That provides am unequivocal answer to the case of "funded debt."

The case of "unfunded debt." That is debt not formally organized as a bond issue, but more like a current account with a bank, is provided for in very generous amounts in subsections 1(i)r the case of the federal government and subsection (j) for any province:

(i) Make loans or advances for periods not exceeding six months for the Government of Canada or the Government of any province on the pledge or hypothetication of readily marketable securities issued or guaranteed by Canada or any province:

(j) Make loans to the Government of Canada or the government of any province, but such loans outstanding at any time shall not, in the case of the Government of Canada or the government of any province, but such loans outstanding at any one time shall not, in the case of the Government of Canada, exceed one-third of the estimated revenue of such government for its fiscal year, and shall not in the case of any provincial government exceed one-fourth of such government's estimated revenue for its fiscal year; and such loans shall be repaid before the end of the first quarter after the end of the fiscal year of such government."

However, though this is clearly stated in the *Bank of Canada Act*, countless requests for such loans from municipalities have received the blunt reply that the Bank of Canada does not make loans even for essential investments to governments. But our sharp-eyed lawyer will not fail to notice – and rightly he should – that these subsections provide that the central bank "may," but not "must" make such loans.

The answer to that legitimate question, however, is provided in the same Act subsection 14(2) that reads:

"If, not withstanding the consultations provided for in subsection 14(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 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." That could hardly be clearer.

How then can the persistent policy of the Bank of Canada and the Government contradict the basic monetary legislation of the land?

Surely the discrepancy would convince any aspiring lawyer to identify this government as what the current US Foreign Minister in commenting on the contradiction between the official government of Lebanon and its Hezbollah cabinet members as a "failed state," one in which there is no coherence between its professed legislation and its conduct.

But states do not simply fail. They are forced into failure by powerful forces with goals outside the law.

William Krehm