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CONTENTS

- 4 Cowichan Citizens Coalition
- 5 Has Our Stock Market Liquidity a High Alcoholic Content?
- 6 No Bankers' Exit in the Skies
- 7 On Social Credit and Socialism, Malthus and Ricardo
- 9 Canada Needs Serious Accountancy to Look After Its Rapidly Aging Population
- 11 A Season for Victimizing the Most Vulnerable
- 12 China's Heavy Metal Food Poisoning
- 13 Some Thoughts on an Opaque Subject — Money
- 15 Holding Back a Financial Hurricane with Pea-Shooters
- 16 Does Union Always Mean Closer Together and Never Further Apart?
- 17 The FDR was Also Stricken by the Collapse of the Eastern European Common Market

Is Toronto's Mayor Sending His Bolts in the Proper Direction?

*Mayor David Miller
City Hall, Toronto*

Dear Mr. Mayor:

I refer to the front page article in The Globe and Mail (17/07, "Miller's tax push fails by a single vote" by Jennifer Lewington and Jeff Gray) that begins: "In a stinging defeat for Toronto Mayor David Miller, council balked at approving two new taxes, for now, in hope the delay will put the city's fiscal future front and center in the provincial election this fall."

That would still not put in proper perspective the problem of the dilapidated finances of our increasingly potholed metropolis.

To help us there I will refer you to some earlier correspondence that you had from our organization, the Committee for Monetary and Economic Reform.

The Bank of Canada to the Aid of our Stressed Municipalities

I refer to your recent appearance on CTV in which you pointed out that it will be years before the Toronto subway system is extended to our airport, I note, too, the letter to you of Richard Priestman of Kingston, a leading member of the Committee on Monetary and Economic Reform, sent to you on January 21, 2005, in which he referred to the use of the Bank of Canada, and its provisions under guarantee of either the federal or provincial governments to finance essential investments by municipalities.

Since 1938 when a Liberal government nationalized the Bank of Canada, the interest on such loans, less the overhead expenses for the service of the BoC, would revert

Continued on page 2





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Mayor *continued from page 1*

to the federal government as dividends. Thus the extension of Toronto’s subway you mentioned would be an investment from which the entire nation, including the federal government would benefit. Not only would it allay the congestion and pollution on our highways, but bring home earlier to their children the two wage-earners that have become necessary to support a family. Moreover, given the long depreciation periods for the tunneling structure in extending the subway, the corresponding investment could claim very long depreciation periods, revealing a far truer and better balance of the books than has appeared for years due to the disregard of the advice of the auditor-general of the federal government.

This matter of depreciation of government investments is of crucial importance, in view of its belated recognition by the federal government. It was only when the previous Auditor General, Denis Desautels, in 1999 refused to give unconditional approval to two successive federal balance sheets unless the capital investments of the federal government were treated as such instead of being written off in a single year as current expenditure. No explanation of the immense significance of this step, was given to parliament or to the public. Nor has the provision of the act in question have had time to work itself through to show up fully in the federal government’s accountancy. When it will, the entire net “worth” of the government will jump substantially and the relative government debt will shrink – because of the highly valuable assets of the government that have been carried for so long on its books at a token dollar. That, of course, has driven down the assessment of the appraisal agencies for the creditworthiness of our government, and driven up interest rates.

The Government’s Investment in Human Capital Still Ignored

Moreover, the investment of government in human capital – education, health, social services – was not even mentioned during the long wrangle between our Prime Minister, at the time Finance Minister in the Chrétien government. And yet such human capital had in the 1960s been widely recognized by economists as the most productive investments governments can make. In the light of such lapses, the really relevant question is: can we afford *not* to make that investment rather than to make it?

Once that question is answered, the

means of financing the project can be found in the *Bank of Canada Act*. In sections 14, 17 and 18, as well as in the preamble, you have all that is necessary to permit the financing of capital projects of the federal and provincial governments, and with the guarantee of either of these senior levels of government, of any corporation. The latter would certainly include municipalities. The Bank of Canada was nationalized in 1938 by a Liberal government headed by William Lyon Mackenzie King, but significantly spurred on by another mayor – Mayor Jerry McGeer of Vancouver. The interest received on such loans does end up with the federal government in the form of dividends.

The Major Source of Our Municipalities’ Troubles

However, because of the discontinued use of this facility still provided for in the *Bank of Canada Act*, the politics of this country have become a ceaseless wrangle amongst the federal government, the provinces, and the municipalities, resulting from the downloading of social programs from Ottawa to the provinces and from the provinces to the municipalities without adequate funds to take care of these programs. There should thus be no problem in negotiating arrangements under which the federal government could arrange the financing of such programs with its central bank, and a negotiated sharing amongst the three levels of government of the increased dividends that would come to Ottawa from such transactions with the municipalities to help cover the net cost of the programs downloaded onto them. We would expect you, Mr. Mayor, as head of the largest Canadian municipality in leading the demand that the nationalized Bank of Canada be used as is still provided for in the *Bank of Canada Act* on our law books. The continued failure to do so undermines the very concept of a democracy.

The source of the deepening financial trouble of our municipalities, Mr. Mayor, can be traced directly to the deregulation of our private banks from the severe requirement imposed on them during the 1930s that they stick to banking, rather than take over interests in the other “financial pillars” – stock brokerages, insurance and mortgage companies. There was a reason for that restriction. Each of these other financial “pillars” had its own liquidity pools needed for their own business. Allow the banks access to these and inevitably they would apply what was known as the “banking multiplier”

– lending out many times the amount of the actual money in their vaults or kept with the central bank. And that in turn is then used for speculations in areas incompatible with banking. That is what brought on the Wall Street crash of October 1929 that ushered in ten years of Depression and led on to World War II. And to prevent that from happening again, under President Roosevelt in the US banking legislation was brought in that after bailing out the banks, severely restricted them to banking. That legislation became the model for much of the non-Communist world.

The Bank of Canada, which had opened its doors in 1935 as a privately-owned institution with 12,000 shareholders, was nationalized in 1938, when the shareholders were bought out at a handsome profit by the federal government. That established the money-creating circuits that made it possible for our government to cover 16% of the cost of its part in World War II by interest-free financing through the Bank of Canada. In the 1970s, before the development was reversed in a surge of “deregulation” of the banks, the portion of our money supply created by the Government spending it into existence by financing of its projects with the Bank of Canada had exceeded 22%. Since 1971, when Canada with the rest of the world went off the gold standard, there has been no other legal tender than the debt of our federal government.

That arrangement had nothing to do with “funny money,” but rather with the good capitalist institution of the dividend. It made it possible for Canada after War II to catch up with the neglect of a decade of Depression and six years of war, to assimilate a flood of mostly penniless immigrants from Europe, educate our baby-boomers and their children to standards undreamt of before the war, install the infrastructures of an industrialized, urbanized country in what had been a semi-rural country in 1929. Today we are back to a very similar position to the one that brought on the 1929 stock market crash and a decade of depression. Bit by bit, and speeding up in the 1970s, the restrictions on keeping our banks confined to banking, have been relaxed. In the 1980s the banks lost much of their capital in the US, in Canada and throughout the Western world. To bail them out they were relieved of the need to re-deposit with the central bank from 4% of the term-deposits taken in from the public and 12% in checking accounts. On these they earned no interest. These statutory reserves

gave the central bank an alternative to using its overnight benchmark interest rate as the sole means of influencing the economy raising its benchmark overnight interest rate when it judged the economy overheated and lowering it when it wanted to encourage more economic activity. With the phasing out of reserves, the benchmark interest rate became the sole lever for influencing the economy. Interest, however, is the basic revenue of money-lenders and banks, and is also an arm-breaking tool for speculators intent on producing bankruptcy bargains. That was tantamount to crowning our banks and other money-lenders financial monarchs of the land.

Even earlier in 1988, The Bank for International Settlements, a sort of private club of central banks that served as a semi-underground war room for organizing the great comeback of the banks to their pre-1929 powers, declared the debt of developed countries “risk-free” and thus available to banks without any down-payment. This led to our banks quadrupling their holdings of federal debt to some \$80 billion *with no money down*. This created the bulk of the present national debt, and the down-loading of social programs without adequate funding to pay for them, from the federal government to the provinces, and from the provinces to the municipalities. That is at the very core of your taxation problem that prevents you from giving your voters the leadership that we know you to be capable of.

Why the Bank of Canada Act is Still on Our Law Books

In the previous correspondence that members of our organization have had with your staff, it appears that they were content to consult the Bank of Canada and were told that it was not able to make loans to the municipalities. What your staff should have consulted was not the Bank of Canada staff or its website, but the *Bank of Canada Act*, that is still intact on our law books though wholly disregarded. That it still remains so tells us a great deal about the state of democratic process in this land. Under PM Brian Mulroney, the government in 1982 proposed putting the independence of the BoC from the government into the Constitution that was being drawn up, as well as “zero inflation.” However the government caucus on the federal House Committee on Finance voted down its government’s proposal. After that, no one has dared meddle with the *BoC Act*.

We note from the subsequent *Globe and*

Mail (20/07), the head of the lead article “City Threatens to shut Sheppard subway.”

In short, Mr. Mayor, someone on high would seem to be making it simple and clear for you and the city council to look beyond the coming provincial elections to the legislation that got this land out of the Depression, helped us pay for our part in World War II, and do a brilliant job of catching up with 16 years of Depression and War, assimilate a flood of mostly penniless immigration to standards undreamt of before the war. Toronto’s growing budgetary problem lies basically not in Queen’s Park but in Ottawa, where the *Bank of Canada Act* that is still on our law books provides everything essential for sharing the advantages of the federal government’s ownership of our central bank.

There are times, Mr. Mayor, when destiny seems to have dealt the decisive cards to an official in public office. Jerry McGeer, the Mayor of Vancouver who did much to push William Lyon Mackenzie into nationalizing the Bank of Canada took advantage of the hand dealt him.

We of the Committee on Monetary and Economic Reform are prepared to outline to you the details of what can be done with legislation still on our law books – in complete confidence.

William Krehm

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Cowichan Citizens Coalition

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December 24, 2006

Honorable Jim Flaherty, Minister of Finance
House of Commons, Parliament Buildings
Ottawa, ON K1A 0A6

Dear Sir:

Re: The Bank of Canada and Why It was Created

The purpose of the Cowichan Citizens Coalition's Duncan Initiative is to remind elected officials that:

1. The *Canadian Constitution Act* of 1867, article 97, gives the Government of Canada the "exclusive" right to create the nation's money.

2. The statutes of the *Bank of Canada Act* of 1934, article 18(1)(c) and (j) spell out clearly how governments, federal, provincial, or municipal, borrow from the Bank of Canada for public projects and services with little or no added interest.

Sir, "money exists not by nature *but by law*" as Aristotle stated 2300 years ago. Article 14(2) places you, an elected official of Canada, as final authority for Bank of Canada policy. You hold all the shares of the BoC on our behalf. Your duty is to uphold that BoC law.

On September 30 you declared a [budget] surplus of \$13B which you would use to pay down the debt. Why would you not borrow that \$13B to pay down the debt from the Bank of Canada interest free, and use the \$13B surplus to provide urgently needed social services like child care or housing for thousands of homeless Canadians?

Elected officials did use our Bank of Canada effectively from 1935 to 1974. In 1974 our national debt, dating back to 1867, stood at a mere \$18B. According to the Auditor General's report of November 1993, that debt had risen to \$423 billion, of which \$386 was entirely interest on interest. (please refer to attached graphs). Please note economist Jack Biddell's figures: income taxes paid by Canadians from 1981 to 1995 totaled \$619B. Interest paid to private banks during the same period totaled \$428B.

On November 14, 2006, the Fraser In-

stitute stated that our current direct governmental debt stands at \$798 billion. As elected lawmakers of Canada, how do you and your fellow elected lawmakers justify the abdication of this "*most conspicuous and sacred responsibility*" as stated by Prime Minister William Lyon Mackenzie King in 1938? Please be honest and thoughtful with your reply. Note the words of economist, John Kenneth Galbraith: "The study of money, above all other fields in economics, is one in which complexity is used to disguise truth or to evade truth, not to reveal it."

Sincerely
William E. Abram

Gerald Gratton McGeer, the True Father of the Bank of Canada

Compiled by Bill Abram

Gerald Gratton McGeer was one of the most outstanding British Columbians of the last century. He could easily have ranked with Tommy Douglas as the "Greatest Canadian." McGeer was a powerful political orator, colorful, flamboyant and energetic. He could "charm the birds out of the trees one moment and then, with the vice of a buzz saw, demolish his opponents" McGeer left a legacy that still touches all Canadians.

Born in Winnipeg on January 6, 1888, he attended Mount Pleasant School in Vancouver, but dropped out at the age of fourteen because he was bored with school. He turned to manual labour in the iron foundry of Letson, Burpee & Company on the Vancouver waterfront. McGeer became a journeyman iron moulder and a highly-active member of the International Iron Moulders of America. Here he fought against unfair working conditions and became the organizer of several strikes. His overly bright and active mind told him that to change things, he must get into positions of power.

His choice was the legal profession. At the age of twenty-two, he completed high school matriculation in six months with nearly perfect marks. Then, in October 1911, he enrolled at Dalhousie University where he became a stalwart debater in the Dalhousie Mock Parliament. He continued his studies at the Vancouver Law School. An excellent lawyer, he partnered with Gordon Wismer and his enduring contribution to our provincial prosperity came in the (Crow) freight-rate cases of the twenties.

McGeer served two terms in the BC

Legislature, from 1916 to 1920 and 1933 to 1934. He became a member of the Federal Government in the election of 1934 and served as a MP for the next 10 years. He also served as Vancouver's popular Mayor in the tumultuous years of 1935 and 1936 and at the time built his most visible monument, the "noble" Vancouver city Hall. He put the Port City of Vancouver on the world map. In 1947 he was elected a second time as mayor, only to die in office two years later at the age of 59.

McGeer wrote many papers and pamphlets on money, and how usury and other sleight-of-hand debt scams destroy its greatest benefit to mankind. His book, *The Conquest of Poverty*, published in 1935 would make a good read. Unfortunately only a few excerpts are available today, and the book has been removed from public archives.

McGeer insisted that no nation is able to control its economy without a publicly accountable national bank. He was Mackenzie King's most reliable advisor. He exposed the flaws of the recommendations of the Lord Macmillan Committee on Banking. His logic prevailed and we got our Bank of Canada.

The following quotation is taken from McGeer's report of 1933 entitled *The Toll Gate*. "The barrier that now blocks the way to progress is the misguided management of public credit by the private money system. We must wipe out that 20th century anomaly in much the same way, and for the same reason that we wiped out toll gates and private management of public roads and highways in the 19th century and establish in its place national maintenance, control and regulation of the issue and circulation of public credit as the means of supplying the capital now required."

[For having failed to do that, we have since gone far towards bringing back privatized public roads, and even the sale and lease back of public buildings. The weakness of the deregulated banking system is that to satisfy its compulsion to grow at an ever higher multiple of the previous rate that have already been incorporated in advance in the prices and options granted high executives, it knows no upper bounds. It tells us that it must be recontrolled and reregulated, failing which it must inevitably destroy both society and itself.] ■

RENEW TODAY!
(SEE PAGE 2)

Has Our Stock Market Liquidity a High Alcoholic Content?

For many years we have tried getting across the point that using advanced mathematics and abundant statistics in no way guarantees their relevance to the real problems we are supposed to be dealing with. Now we have a similar conclusion on the front page of *The New York Times* (20/07, "Market Shock: AAA Rating May be Junk" by Floyd Norris): "The great stock market rally of 2002 through 2007 has been built on liquidity – and much of the liquidity has been based on financial engineering that allowed highly risky investments to be financed by investors who thought they were taking no risks.

"They were wrong. Now the question is whether the market can continue rising as investors learn that the financial innovations that helped build the boom were constructed on sand.

"When Bear Stearns admitted this week that two hedge funds were expected to lose, in round numbers, 100% of their value, it blamed 'unprecedented' declines in the valuations of a number of highly rated (rated AA and AAA) securities.

"These securities were nothing like the bonds issued by companies with triple-A or double-A ratings. Such bonds almost never plunge in value because the companies borrowing the money are financially solid. But the money invested by the hedge funds went to finance mortgage loans to subprime customers, borrowers as close to being triple-A credit as Moscow is to Maui as a beach resort."

"By the magic of securitization, sow's ears could become silk purses, or at least look like them. Most subprime mortgages would never default, went the theory, and rising home prices would soon minimize losses when there were defaults. So if a security was protected from the first 10 or twenty percent of losses in a mortgage portfolio, then it was as safe as a loan to General Electric. Such securities got AAA ratings.

"Securities with a greater exposure to loss could still get investment-grade ratings. All told, the vast majority of the money that financed risky loans appeared to be invested in investment-grade paper.

"The buyers of this supposedly safe paper in the subprime mortgage market are now suffering not so much because of the

defaults that have already occurred but because of the defaults that investors fear.

"The rating agencies are threatening to downgrade some AAA-graded paper, and there is rising nervousness about bonds issued by companies like the MBIA and Ambac that guaranteed some of those AAA securities. The shares of a smaller insurer, ACA Capital, have lost half their value in a few weeks. An index of shares in six financial industries has lost a tenth of its value since the end of May. Investors are already backing away from securitizations of sub-grade mortgages, making such mortgages more difficult to obtain.

"As a minimum, it seems likely that securitizations to finance junk corporate loans will be harder to put together, and that buyers will demand higher yields for even the safe parts of them."

For such securitizations grade the exposure of those buying a tranche with greater or lesser risks. Those opting for greater risk absorb more of the initial losses but have a claim on a greater share of the profits, if, indeed, there should eventually be overall profits distributed. And, of course, part of what the buyers of whatever tranches are betting on is the direction taken by the economy, the course, of interest rates, the economy, taxes, and the housing market, and much, much else.

The mere process of disentangling the interests of lenders that can cover scores or hundreds of different mortgage loans, some of which may be in default, is daunting and time-consuming. Obviously, in the piggy-back ride on the high-finance beast such complications seem to have transferred to finance the biological disaster of twins being born with joined heads. But such is the prestige of differential calculus that it is mistaken for a solution to the problem, rather than a single one of the countless techniques of mathematics that must be selected for their appropriateness in dealing with the specific problem. To assume anything more than that is to invite villainy rather than simple naïveté.

The course of financial policy since 1970 makes urgent a re-examination of the economic theory that has taken over during the past four decades.

W.K.

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No Bankers' Exit in the Skies

Our financial markets are riding big on what they choose to call “risk management.” Yet the evidence is piling in, on earth and in the skies, that what really underlies the notion of risk management, is quite another institution strictly confined to the corporate world, known as “banker’s exit.” It can be translated into popular language as “unloading a deal on a bigger fool” after the organizers have taken their profit.

The myth of this alleged “risk management” is unravelling in the sub-prime mortgage market that is currently roiling the banking world in the US and Britain. And banking these days with its deregulation and globalization covers pretty well the entire financial world. Its cardinal weakness is that to avoid falling on its face it must go on growing ever faster.

There was a time, during the Depression of the 1930s right until the 1960s when banks were not allowed to engage in mortgage financing. For the Depression had been caused in large part by the banks getting their hands on the liquid capital reserves of “the other financial pillars” – the stock market, real estate and insurance. Grant the banks access to these pools, and they will use them as money base for their banking – the essence of which is lending out a multiple of the actual cash and near-cash in their possession (“near cash” is short-term debt of the highest quality and bearing interest that government debt spent into existence does not). That is a useful institution for avoiding tying economic development to the amount of gold that has been mined – something that makes no sense. But it was an institution that unless strictly controlled could keel over into scam. For through the very institutions of democracy – become creaky through corruption – the banks could acquire the political clout to become deregulated to serve themselves rather than the economy and society at large.

The Line in the Sand

The line in the sand never to be crossed is this: the banks, though lending out a greater multiple of the cash and near-cash, must always be able to honour any claim of a depositor. For failing that, the whole structure of trust that banking rests on collapses, and there will be a run on banks throughout the land. Part of the revised banking formula that helped the world banks out of their

bankruptcies during much of the 1930s was the intervention the state through their central banks as “lenders of the last resort.”

A key component of the current rage for “risk management” is the syndication of debt and its marketing by banks and other financial institutions into a huge assembly of mortgages or other debt in “tranches” graded according to their degrees of risk. Those who opt for more risk, will absorb a disproportionate part of the first losses suffered, but in return will come in for a greater share of the final profits – if, indeed, there are profits resulting from the whole syndication. And those less ready to handle risk, will get less of any eventual over-all profits.

Greater “Efficiency” of Syndicated Mortgages

With the prevailing compulsion to grow, some basic flaws in this construct were overlooked. When mortgages were not syndicated, brokers checked the applicants’ credit records against tax documents and other sources. Once they were syndicated, it was deemed a heightened efficiency of the organizer of the syndication and the agents they purchased the individual loans from, to skip such costly formalities. Hence, “lie loans” multiplied – and the expression has even become current in the business. So long as houses were in short supply, and hence many overextended borrowers could get out with a profit, by reselling the dwelling, all went famously. But when the housing market became oversupplied, mortgages fell into default, and the balance sheets of banks began to bleed.

Though the sub-prime mortgage situation has still not become critical in Canada, our banks are anything but immune to what is happening in the US. The Bank of Montreal, which had already lost heavily in gas and oil speculations and in the Enron mess, does 9% of the banking activity in the Chicago region, and other banks are well represented in the US and the rest of the hemisphere. Globalization as well as deregulation will thus be contributing to our banks’ vulnerability to the compulsion to grow bigger in order not to fail.

Now let us take a closer look at the “risk” aspect. The only serious risk management is insurance, whether the insurer is an outside insurance company that seeks liquidity and profits by balancing its risk portfolio, or the

company insured arranges to balance its risks and available assets internally. In either case that is a serious affair subject to rigorous disciplines. There is no Banker’s Exit, no reliance on a “finding a bigger fool” for taking the problem off one’s hands and leaving you with a profit.

A Word on Insurance

There are, areas, moreover, where forging insurance could have such annihilating consequences far greater than those accepted by insurance companies or recognized for what they are by governments. I refer to global warming. The consequences of a warming planet whether there is absolute certainty that it may be mainly due to human production of CO₂ and other green-house gases or not, is not what is most important at stake. In either case, the consequences would be sufficiently devastating to call for insurance. After all, you do not delay insuring your automobile until you are certain that you are going to have an accident. The very uncertainty and the mere danger is what makes possible both the need and possibility of insurance. To put global warming into proper perspective, the highly relevant concept has been little or never used – “insurance against.”

Let me quote *The Wall Street Journal* (07/06, “As Insurers Flee Coast, States Face New Threat” by Liam Plevin): “As hurricane season gets under way, a dramatic shift in the way homeowners insure against disasters could cause a big financial risk in several coastal states.

“Private insurers have been fleeing the shoreline, wary of costly storms, and often fed up with government regulations that prevent them from pushing rates higher. In more than a dozen states along the Gulf of Mexico and the East Coast to Massachusetts – an odd breed of carriers known as ‘insurers of the last resort’ is filling the void.”

Down to its bare essence, what is happening in these states is a shift from external to internal insurance, because the game is judged too dangerous for routine insurers to dare play. The authorities had postponed restricting such emissions because they claimed uncertainty that the planet is warming because of human behaviour. That is a key neglected aspect of the problem, for a Washington that is still waiting for 100% certainty instead of regarding the control of

CO₂ emissions as an insurance measure.

The *WSJ* continues: “At a time when financial markets are becoming increasingly adept at spreading risk, the states and federal governments are concentrating it on a massive scale. The shift contrasts starkly with the federal government’s efforts to make individuals assume more risk and costs in other areas, such as retirement and health-care plans.

“Last-resort insurers are created by state governments, although they operate very much like other insurance companies. Many of them are set up as associations, which actually write policies that cover hurricane damage from wind, among other standards.

“In a catastrophic situation, the associations are often authorized to impose assessments on all their member insurers. That can translate into rate hikes or surcharges for policyholders throughout the state – not just in places hit by the storm.

“States have strong incentives to make coverage available, since most banks require insurance before they write a mortgage. Most insurers of the last resort were established in the late 1960s, when urban riots led private insurers to shun some inner-city properties. Today they insure a broad spectrum of homes.”

Expensive Memories of Past Hurricanes

“Massachusetts hasn’t been hit by a major hurricane since 1954. But in the wake of severe storms elsewhere, some forecasters believe that could change. Companies that build computer models say the losses could be enormous, which has frightened insurers all along the Eastern seaboard.

“A severe storm in Galveston, Texas, site of a deadly 1900 hurricane, could cost the Texas Windstorm Insurance Association, the state’s insurer of the last resort, as much as \$8 billion, officials there say. The association and its member insurers would be able to cover about \$700 million in losses. Beyond that, it would need to ask all its member insurers to make up the huge shortfall. They would be permitted to recoup the funds through tax credits – a potentially big hit on the state budget.”

W.K.

On Social Credit and Socialism, Malthus and Ricardo

We have received from our regular contributor, Keith Wilde, some interesting views and correspondence from which we publish excerpts below most directly relevant to the scope of this modest publication. We quote:

“The feature of the 1924 essay of John Maynard Keynes that particularly riveted my attention was its demonstration of how difficult the communication of ideas can be, even of persons of great good will, urgent and shared intent. It evokes some sympathy for the frustration of Keynes’s contemporary, C.H. Douglas, who is subject of the second appendix and shares the preference for Malthus’s approach to economic reasoning. Douglas is famous as the founder of the Social Credit movement. After decades of prescribing a solution to economic problems and warning about the consequences of prevailing policies, Douglas wrote that considerable conversation with men lauded as Britain’s ‘brilliant new political figures’ (1946) persuaded him ‘that a stone-mason’s chisel is the only argument which might have inserted an idea into their heads.’

“When Keynes came to writing *The General Theory* (1946), he included reference to earlier authors who had focused on the problems of under-consumption. Malthus is first among these, but Keynes mentioned several who had taken up the theme in the intervening decade and includes Douglas. It had been a long time since I had read *The General Theory*, and I did not remember the emphasis on Malthus’s approach. I therefore asked a specialist for comment: ‘The second of the appended items is Victor Bridget’s response to that request. Bridget resides in Australia and appears universally recognized within the interested community as an authority on the literature.’”

The Fabian Diversion

“This exchange with Bridget led to a brief text that differentiates both Keynes and Douglas from socialism. It is an essay by G.D.H. Cole about Fabianism in the 1932 *Encyclopedia of the Social Sciences* (itself still an unavoidable reference work in these fields). The Fabian Society became famous in the late 1880s through the writings of George Bernard Shaw and Sidney Webb. Their intent, says Cole, was to present an

alternative to Marxism. ‘Whereas Marxism looked to the creation of socialism by revolution based on the breakdown of capitalism through its inability to solve the problem of distribution, the Fabians expected socialism to come as the sequel to the full realization of universal suffrage and representative government.’ In their view, the economic position of workers was improving through gradual progress of legislated social reform ‘within the framework of capitalist society.’ As expanded below, Douglas disagreed diametrically with this scenario. Keynes and Douglas both disagreed with the socialists’ preference for Ricardo over Malthus.

“The cornerstone of Fabian economic theory, says Cole, was the Ricardian law of rent. Ricardo pioneered the definition of economic rent as unearned income by noting that the owners of highly fertile lands get a greater return than those who work just as hard on poorer soil. The Fabians applied this reasoning to capital and to personal ability as well. ‘They considered large income to be chiefly rents arising from the possession of differential monopolies and maintained that these rents belonged properly not to the monopolists but to the community as a whole. The economic problem was thus presented as a question of the socialization of monopoly incomes through the social ownership of the monopolies.’ The idea that if land could not belong to all the people, that they ought at least to share in the rents from its differential qualities had been around since the 18th century, says Cole. The doctrine of socially appropriating it via a single tax ‘had received tremendous impetus from Henry George, [and] had been broadly endorsed by the great authority of John Stuart Mill. The socialization of industry seemed a natural and logical extension. It became a permanent feature of British policy under the Labour Party after WWII.

“The policy prescription of both Keynes and Douglas are frequently described (loosely) as ‘socialistic,’ but this description of Fabianism makes it easy to distinguish both of them from the real thing – and from each other. The chief contribution of Keynes has been in macroeconomic management to achieve the legislated goal of ‘full employment.’ as a means to a satisfactory distribution of incomes. By contrast, Douglas and

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his followers were full of scorn for both the nationalization of industries and the full employment objective. To understand why, first recall the difference between Malthus and Ricardo and add to that the observation that reformers of the under-consumption persuasion generally focus their policy emphasis on the inadequacy of money or credit supply. By contrast, those of the Ricardian persuasion favour taxation and redistribution of the existing flow of money and credit. Henry George's single tax is of the latter kind, and Social Crediter vehemently object to being associated with the Georgists. Nationalization is similarly a measure of the tax-and-redistribute approach. Keynes' analysis begins with the under-consumption and money-insufficiency approach, but the policy of economic-growth-for-full-employment associated with his name comes down to a tax-and-redistribute in the ways it has been applied.

"Perhaps it need not be said that money reform is more radical than those of the socialistic variety. At least that is the evidence of modern history up to now. Instances of money reform are few – if any there be. The belief spread by Fabians that fundamental reform can be effected through democratic processes is regarded by Douglas and his followers as a major deterrent rather than a progressive instrument."

Enter the Cultural Heritage

"The latter point was driven home to me in a recent conversation with Robert Klinck, formerly a parliamentary researcher for the federal Social Credit Party, and still president of the National Region. We were discussing my uncertainty over what Douglas meant in describing Social Credit as 'the policy of a philosophy.' Klinck proved to be more illuminating than I had dared hope.

"I stumble on giving the name 'philosophy' to 'a view of reality,' at least to a part of reality. When I hear the word philosophy, I envisage it as comprising both a world view and values – 'what is' and 'what ought to be.' In the Douglas statement, 'the ought to be' portion is not explicit but implied in the question what action is to be taken. Some of the key elements of his world view, values and questions are:

"1. The state and level of technology and of extant physical and social capital is a 'cultural heritage.' It is properly conceived as collective property and the income from it should be shared equitably. Although this sentiment is similar to that which inspired taxing rents as unearned income, that is not

the inference made by Douglas.

"2. Instead, the benefit of the cultural heritage should be shared by means of a continuous reduction in the need for direct human effort in production.

"3. Enter at this point Douglas's rather idiosyncratic views on religion. The *Old Testament* perspective entails the necessity of work (good works); Christianity introduced the freedom of grace: consider the lillies of the field; they toil not, neither do they spin,' but who among you are more gloriously dressed among them than they are! Douglas and his followers take this literally.

"4. A complication is that the capacity to satisfy basic human needs from an ever-decreasing amount of direct effort should increase the amount of time individuals have for leisure. activities. A further implication is that the beneficial use of leisure in cultivating physical, social and intellectual graces has been the source of human progress as represented in the cultural heritage. The emphasis on minimizing essential work so as to focus on cultivating physical, social and intellectual graces has been the source of human progress as represented in the cultural heritage. Historically, it was not force, 'just grewed like Topsy' – or in Klinck's word, organically.

"5. Freedom of association is a paramount value for Douglas. Individuals should be free to come together in association for common purposes, but it should always be possible for anyone to withdraw. This is an anarchist attitude towards governments, consistent with the rejection of confiscatory taxation of unearned incomes. The power of corporations over the lives of individuals is implicated as well, but it applies to employment and jobs income rather than to the voluntary participation of persons with excess cash to invest in shares.

"6. Thus the great inhibitor to a free and prosperous society is the control that is exercised over industrial enterprises and governments by internationally integrated financial powers. This is done by the contraction of credits as loans become due before the money has completed rounds through the consuming side of the production-distribution cycle. Douglas's solution was the extension of credit to close the gap."

The Development of World Dominion

"The rejection of his solution was interpreted by Douglas as evidence that those on top in society, in our era the financial powers, wish to keep the rest of humanity in slavery. For their solution to insufficient

demand is "jobs, jobs, jobs. The Keynesian-style solution, therefore only aggravated the essential problem. In his later years Douglas was vehement about the international financial conspiracy as the facilitator of wars, and the perpetuator of organizations and programs to assure the narrow concentration of global power and the subservience of the masses everywhere. His thinking blends in almost seamlessly with the twentieth century protest literature that focused on the control of government by financial elites."

There is only one additional development that I would like to add to Keith Wilde's exposition.

If we start out with a conviction – expressed or not – that there is only a single philosophy or reality to be confronted, then the different approaches of historical non-Fabian socialism and social credit of Keith must be seen as competitors for power as were the Russian Bolsheviks and Mensheviks in 1917, the former opposing the imperialist war, and most of the latter supporting it. However if we grasp the ever evolving complexity that the deregulated and globalized financial system has become, and if we reflect on the ever tighter range and tangle of the resulting problems, we will reach out for systems theory to cast a more helpful light on the problem. Three or four decades ago, there was growing evidence that the economic faculties of our universities appeared to be looking to systems theory courses to help shed further light on the economic reality that governments and parliaments were confronted with. Classical economic theory was getting into ever greater trouble trying to run a society tripping over a growing number of independent variables while its guiding economic theory recognized only two – supply and demand. And yet the experts who prided themselves on their grasp of higher mathematics had all been taught in their first year high-school algebra classes that if you have more than two independent linear equations you must have at three independent variables for their solution. That was packaged by a Dutch physicist turned economist, name of Jan Tinbergen, and came to be known as Tinbergen's "Counting Rule." It might have prevented economists from making too great fools of themselves. However, since the self-balancing market with its two wondrously versatile variables of supply and demand better served those in control of the economy, Tinbergen and his Counting Rule were buried more deeply than the regulatory six feet, and all other variables – including health and the envi-

ronment – were declared “externalities.”

Now as Keith Wilde has posed the problem, it becomes obvious that the particular difference in approach of social credit and conventional socialism to the multiplying variables of the real world, could provide some of those additional independent variables to cope with the multiplying problems that are overwhelming the world.

How would this make for an enrichment of more orthodox socialist theory by social credit and vice versa? We are, though our hubris has prevented our recognizing it, a

subsystem of the planet. Unless humanity learns to respect and preserve the planet as a place where not only the human race might survive but possibly life of any sort for millennia or forever. Hence might it not be in place to mark out entire areas particularly vulnerable to pollution and other disturbances of the environment for special treatment? These could be established as reserves, and people wishing to lead quieter lives as farmers, gardeners, living largely on their social dividend, out of the rat race, devoting their leisure to the arts, letters

whatever, with restrictions on motor cars, providing surcease from the bustle of the present world. Need I say more? I would not besmirch such a vision with the suggestion that they could supplement their social dividend by selling their pollution rights. Because the essence of this grand alliance I propose between all money reformers and social credit and the greens is that nobody in such reserved areas would have the right to pollute, or to transform it into a right that under law could be traded and banked.

William Krehm

Canada Needs Serious Accountancy to Look After Its Rapidly Aging Population

Population trends echo the disasters of the Great Depression of the 1930s. First, those that brought us the hollow years of the 1930s when many people could not afford to marry and have children. Then came six years of world war with a good part of our younger population overseas, rather than founding families at home. A wretched economic theory made it next to impossible to get the economy working again *without* the bloody world war.

The Bank of Canada was founded as a private institution in 1935, and in 1938 it was nationalized, when 12,000 private shareholders were bought out by the federal government at a handsome profit. That finally permitted us to catch up with the huge public investment missed during the hollow economy of the Depression.

But now our media and the government are reminding us that those outsized generations of baby boomers will soon be aging. That means the active younger generation will once again dwindle as it is called to support to the growing number of retired people whose ever longer average life span will make it ever more important to rethink the economic dogmas that brought us the Depression and World War II.

The statistics cited are overpowering.

We quote from *The Globe and Mail* (18/07, “A Picture of Canada, 10 years from Now”): “Within seven or eight years, and certainly within 10, the declining number of children in Canada (15 and younger) will be less than the rising number of seniors (65 and older). Based on current trends and projections, Statscan thinks the number of Canadians in both categories will reach about 5.4 millions around 2015. After that

more seniors than kids.

“With so much immigration to Canada, why won’t there be more children by 2017 to offset the demographic heft of the boomers?

“Two reasons. Firstly, the fertility rate, at about 1.5 children per woman, is below the population replacement level. Secondly, life expectancy is increasing and now stands at 82.5 for women and 77.7 years for men. Immigration accounts for two-thirds of Canada’s population growth, which somewhat offsets Canada’s declining fertility rate. However, the average age of an immigrant arriving in Canada is 30 years, and they age like the rest of our population.

“How do we compare to other industrialized countries?

“With 13.7% of our population aged 65 and older Canada is about even with Russia, as the second youngest country in the G8. Only the US is younger, with only 12.4% of its population being 65 or older. Japan, Germany and Italy already have seniors proportions close to 20%. Canada 2017 Canada will likely still have a younger population than other G8 countries, but we’ll have one senior for every five people by the year 2024.

“By 2017, will the federal and provincial governments face a fiscal crisis with such a large senior cohort?

“Thanks to some foresight on behalf of past governments and civil servants, Canada is better prepared to handle a ballooning senior population than many other countries. Today, there are about five working-age Canadians for every senior; by 2017, that will have shrunk to between three and four. By 2030 it will be down to two. Based on cur-

rent trends, however, governments should be able to manage their affairs without incurring massive debts or imposing soaring tax rates due to the burgeoning senior population.”

Arriving at a Crucial Road Divide

There we come to a crucial divide of the road. Before the fine sentiments of the article can be realized it must be translated into a serious accountancy in our government bookkeeping. Without that the assurances offered in the previous paragraph are totally misleading.

Under the Progressive Conservative leadership of Brian Mulroney, when Statistics of Canada published figures showing that the increased deficits of the federal government were not due to increased programs, that in fact had been cut, but to high interest rates imposed by the Bank of Canada, the government simply slashed the budget of Statistics Canada to teach them a brutal lesson.

The result of Mulroney’s essay in statesmanship in this matter has rendered Statistics Canada gagged to provide the essential warnings in good time for Canada to prepare for preparing for explosion of retirees because of a relatively shrinking active population. If we are allowed to prepare seriously for those longer average life spans, it will be a development to celebrate with fife and drum. For all of us look forward to longer, useful and enjoyable life spans.

Shortly before, in the 1960s, Theodore Schultz of the University of Chicago had been awarded the Bank of Sweden so-called Nobel Prize for Economics for having identified the reason for the surprising rapid recovery of both Germany and Japan from

the destruction of WWII. Schultz reached the conclusion that investment in human capital is the most productive that a government can make.

The name of Schultz is forgotten today, and the investment that should have been made in human capital by Ottawa has instead gone instead to bailing out the deregulated and globalized private banks from their ever greater speculative losses. To do this there has been a massive shift of federal government borrowing from the Bank of Canada to the private banks and bond markets. When our central bank holds federal government debt, almost all the interest it pays the central bank comes back to it as dividends. When private banks hold that debt it stays with them. And by 1972 some 22% of the federal debt was held by the Bank of Canada. Currently it is around 6%.

But in the interim the benchmark interest rates for overnight loans charged the central banks has been pushed to the skies in order to achieve “zero inflation.” As a result the federal debt has increased by a multiple close to 5, while the interest on that debt seems about to increase once again.

No Way of Looking After Our Gambling Banks and Our Aging Population at the Same Time

In that setting the fine words quoted above, “governments should be able to manage their affairs without imposing soaring tax rates due to the burgeoning population,” are complete deception.

That will certainly *not* be the case if it uses its powers to bail out our deregulated banks from their heavy losses in speculative ventures incompatible with banking – e.g., the roles of certain of our banks that led to their settlements out of court in the Enron case amounting to hundreds of millions of dollars. And more recently to the involvement of some of these banks with the subprime mortgage mess in the United States.

Under the banking legislation brought into the US under Roosevelt and closely followed throughout much of the world including Canada, banks had been forbidden to acquire interests in the other “independent financial pillars” – to wit, stock brokerage, mortgagees, and insurance. The reason was a sound one, since their adventures in such areas had brought down Wall Street in 1929, ushering in ten years of Depression and leading to WWII. The logic in that measure is that if the banks were given access to the pools of liquidity that these

“other pillars” keep for their own business needs they will lose no time in applying to them the “bank multiplier,” i.e., the multiple of credit a bank can issue as legal tender base. And that is precisely what led to the explosion and loss of much of their capital by our banks in the 1980s.

To bail them out of their losses, the Bank for International Settlements – a sort of central bankers’ club based in Basel, Switzerland – served as the semi-underground war-room to plan and execute the banks’ comeback to their pre-1930s glory-ground. BIS simply declared the debt of the developed countries “risk free” just as the banks did more recently the syndicated tranches of subprime mortgage debt, that has turned out a time-bomb under much of the world banking system today.

And, indeed, their next bailout has long since been planned, with no regard for the priority of senior citizens. Already the federal government has listed key centrally located buildings that the federal government is about to put up for sale with 25-year leaseback to the government, supposedly to help the government catch up with deferred maintenance that it is unable to “afford.”

We would recommend that it consult section 18 of the *Bank of Canada Act* that enables it finance any mortgage the federal government might put on those properties including whatever catch-up might be necessary for any neglected maintenance in these buildings. The feature of these properties in the centres of the largest cities across the land is the building, and their sites will increase in value with all further infrastructures developed by all levels of government in such key areas in the future. That will increase the rentals to bleed the public treasury in the interest of the next great speculative orgy of our banks.

An Investment in the Upkeep of the Aged Contributes to a Happier Existence for All

And since this has priority over anything else in the governments financial operations, we can foretell that there will in fact be no more provision to deal with the thinning out of our work force a decade ahead and for the multiplication of our retirees. There remains only to emphasize the point that a longer and comfortable lifespan for our future retirees, is an essential investment in the mental health and contentment of our active population. Accordingly, it must be seen as an investment rather than a current expenditure. Assured of adequately means

of retirement, many of these numerous senior provided for in this way can undoubtedly be recruited for part-term work that contributes to the government investment in their welfare.

Unless, such public services are recognized as investments in the accounting of the government, they will end up being neglected as a budgetary indiscretion – as an “externality,” along with the environment, and our health systems. What should be looked after for the mental and physical health of our society but is not done, must be entered in the government’s ledgers’ as a government *debit* not as a sign of fiscal prudence.

The only legal tender in this land since the early 1970s has been the debt of the federal government which is spent not lent into existence. By shifting the capital investments from the banks to the Bank of Canada, and stopping the further marketing of public resources to private financial interests, the solution to the problem can be comfortably absorbed into a functional accountancy system.

Such physical assets used to be carried on the books at a token \$1 that opened endless schemes for profitable acquisitions from the public domain of properties “at a profit.” That was changed in 2000 when the then Auditor General Denis Desautels refused to give unconditional approval to two successive balance sheet of the government, unless this were done. But that still leaves uncovered the capital investments to save the environment and in basic human resources such as education, health, and social services.

That must be remedied, and any shortfall in such necessary measures must be treated at a capital deficit. Only then will a balanced or unbalanced budget have a real significance for, not against, society’s welfare. And the Bank of Canada must become the sole bank of the government at least for its investments – physical, environmental, or human. And banks must be confined strictly to banking and stripped of their first call on the public treasury for bailouts from their gambles incompatible with banking. Our history, too, must be recognized as a guide and asset, not to be entered at a given value on our books, but as priceless and irreplaceable. Unless we learn from it, instead of burying it as a dog might a bone, we shall go on repeating the same errors on an ever expanding scale until it leads to the doom of society as we know it.

W.K.

A Season for Victimizing the Most Vulnerable

A disproportionate portion of the talents with which human kind has been endowed by a beneficent Creator has been misdirected by our taking unfair advantage of one another. Sometimes this appears in the garb of high statesmanship, at other times, in less exalted forms they attack the innards of the most helpless with tooth and claws.

Inevitably such perverse talents come to particular flower at a time when a dwelling that might be the last refuge for hiding a broken life and keeping a family together, is hit by a mortgage crisis. This may be brought on less by improvidence of the borrowers than by rumblings in the world of high finance beyond the grasp of ordinary people who work for their living.

In *The New York Times* (3/07, "Predators Find New Schemes to Bilk Struggling Homeowners"), Gretchen Morgenson and Vikas Bajaj tell a tale of just such sordid ingenuity: "With the housing market in decline, financial predators are finding yet another way to take advantage of people who fall behind in their payments.

"The schemes take various forms and often involve promises to distressed homeowners of cash up front, free monthly rent and a chance to retain their houses in the long run. But in the process someone else takes over the deed, borrows as much as possible against the value of the house and pockets the cash. And, almost always the homeowners still end up losing their homes."

Perfect Conditions for Mortgage Fraud to Seem True

"There are no nationwide numbers on this common fraud, known as equity stripping, but it has turned up in almost every state. Seven states have passed laws trying to stop it. Still, with foreclosure rates rising rapidly, it will be a growing problem, consumer advocates say.

"Conditions are now perfect for these scams,' says Lauren K. Saunders, managing attorney at the National Law Consumer Law Center in Washington. 'We are at the end of a period of rising real estate prices, so a lot of people have equity in their homes. But we also have a foreclosure crisis.'

"Gloria and Fred Johnson fell for a sales pitch that they now regret. They had secured their version of the American dream – a home of their own – in the Bushwick section of Brooklyn in 2001.

"For three years they scrimped to save the \$5,000 down payment for a two-family house. They took out a \$226,000 mortgage backed by the Federal Housing Administration.

"But in 2004 an injury forced Ms. Johnson to take a leave from her counseling job at Fountain House, an advocacy group that works with the mentally ill. They struggled financially on her disability payments and her husband's income as a construction worker. By the summer of 2004 they had fallen two months behind on their mortgage.

"So Ms. Johnson called the Home Savers Consulting Corporation, a Brooklyn company that advertised help for people facing foreclosure. 'I was in a tight situation,' she says, 'and was scared to death that I was going to lose my house.'

"Ms. Johnson met with Home Savers officials and agreed to what she thought was a refinancing of her loan at a lower interest rate with more affordable lower payments. But the Johnsons unknowingly transferred their deed to a straw buyer working with Home Savers, court documents contend.

"That stand-in buyer qualified for a type of mortgage that would let him take cash out of the financing. He borrowed \$435,000 against the house and pocketed \$134,000, which included the Johnson's equity built up over the years.

"Now the Johnsons are fighting to recover their equity.

"Jessica Attie, co-director of the foreclosure prevention project of South Brooklyn Legal Services and the lawyer for the Johnsons, said her office was overwhelmed with homeowners who had handed over their deeds to people pretending to help 'save' their homes.

"Such foreclosure-related offers have attracted the attention of legislators, and at least seven states have created laws against them. Last February, New York instituted the Home Equity Theft Prevention which provides legal recourse to victims.

"Victims are becoming more plentiful as homeowners fall on payments and find they cannot refinance with interest rates rising. When a property enters foreclosure, it appears on a list at the county clerk's office. Individuals and companies in equity-stripping schemes monitor the lists closely, contacting troubled homeowners by phone, mail or by

knocking on their doors.

"Those companies advertise heavily in target areas. 'Are you losing sleep because of mounting debt harassing bill collectors?' asked one flyer from a 'foreclosure specialist,' Equitable Estate Solutions.

"Aleem Morris, 30, who lost his job as a forklift operator three years ago, answered that flier. Behind in his mortgage payments on a two-storey home in the Vailsburg neighborhood of Newark. With his ailing 82-year-old grandfather. Mr. Morris was desperate. He had borrowed money from family and friends, but the house went into foreclosure in February, 2005. He owed \$118,000.

"Mr. Morris said he met with Kenneth McKinnon, an official at Equitable Real Estate, and told him that he had bad credit, no job, and was losing his house."

A Swish of the Mortgage Con's Wand and Your Nightmares Vanish

"According to Mr. Morris, Mr. McKinnon told him that these troubles could vanish. Under a complex arrangement, Equitable would arrange for someone else to buy the house – temporarily, as it was explained to him. In return, Mr. Morris would receive \$20,000 in cash and someone else would make monthly payments while he and his grandfather lived there for a year.

"Along the way, the monthly payments would be made in Mr. Morris' name, repairing his credit, so that he could qualify for a new mortgage. After a year, the Morrisses could buy the house back for \$313,000.

"The house was sold for \$315,000. Records show that in May 2006, Mr. Morris received his cash and that his debts, including a tax lien and outstanding mortgage payments were paid. But the remaining \$137,199 which probably represented his equity in the house went to a mysterious 'construction note' that Mr. Morris said he knew nothing about. Mr. McKinnon told Mr. Morris that to make the deal work, a lot of people had to be paid.

"Last October, Mr. Morris was informed that his house was again in foreclosure. Essex-Newark Services is handling his case.

"'I had no idea what I was doing,' Mr. Morris admitted. With the promise of quick money, repaired credit, and a place to live without paying rent for a year, he was easily

Continued on page 20

China's Heavy Metal Food Poisoning

We in Toronto have a growing, prospering Chinese community that we particularly prize – amongst other things for the variety of incredibly good and inexpensive restaurants they have brought us. And equally amazing is the variety of fruit and vegetable shops, selling vegetables both familiar and unfamiliar to us in Canada. Some of these come from China, others are grown locally – there is no ready way of making the distinction. Some of these we have never set eyes on before. They have started turning up in our large chain food stores as well. And what the Lord took the trouble to create, it is simple piety to feel we must sample. However, we now learn that serious dangers come with what we took to be healthy curiosity. Unless there is some assurance that what we eat is adequately inspected for the most dangerous industrial pollution, it is no bargain at any price. What we have here is another disturbing chapter of the brainless adventure of Globalization and Deregulation into which governments have been pushed.

And now we are faced with the need of setting up a new costly apparatus to sort out what is effective control of lethal food pollution we are importing from China. For the most immediate conclusion is that the notorious environmental pollution of China may well be channelled not only into our local restaurants but into private kitchens. In the last analysis it all reduces to the price set on protecting a human life in China. And by the most conservative reporting that price is not great. Yet to deal with that will require not only inspection of imports at the Canadian end, but at the Chinese. And one of the disquieting things about Deregulation and Globalization is that everything is presented as dreadfully urgent, since statistics of profits earned for all corporations must continue increasing at least at the rate of the previous year's figure for that has already been incorporated into their stock market prices well in advance. Thus the derivatives of the growth rate of the value of the options that have been granted the corporation executives for the purchase of their corporation's shares have entered the system. The corporation accordingly acquires a forward lean that produces the risk of it keeling over.

The end result is that we are now faced with a subprime rate of food safety no less

disturbing than the subprime collateralized debt that has become a major concern in our financial sector. So much dependence on future growth does not leave much time for a careful test of the safety of the foodstuffs reaching Canada in ever greater quantity.

Cadmium In Our Kitchens

That is why we are finding the latest flood of disturbing reports of the safety of part of China's food imports reaching us, hitting us below the belt in both a literal and metaphorical sense. *The Wall Street Journal* (02/07/07, "China Faces a New Worry: Heavy Metals in the Food" by Nicholas Zasmiska and James Spencer) is disturbing: "Nanning, China – For nearly two decades, Lai Mandai regularly ate and sold beans, cabbage and watermelons grown on a plot of land a short walk from a lead smelting plant in her village. Like dozens of other villagers who ate locally grown food, Mrs. Lasi, 39 years old, developed health problems. 'When I did work, planting vegetables or cleaning the floor, I felt tired, and my fingers felt numb,' says Ms. Lai. Other villagers had the same problems.

"Mrs. Lai along with 57 other villagers was eventually diagnosed with high levels of cadmium, a heavy metal that can cause kidney disease and softening of the bones. Runoff from the debris of a factory which the government tore down in 2004 – had contaminated the farmland and entered the food supply. A Chinese government report found that rice grown in the village contained 20 times the permitted level of cadmium.

"China's tainted food supply has fallen under heightened scrutiny after a shipment of wheat flour contaminated with a chemical used in fire retardants found its way into pet food and was linked to the deaths of US animals in late March. Concerns have since soared over the safety of the country's exports. The US Food and Drug Administration recently told consumers to stop buying toothpaste made in China because it might contain poisonous diethylene glycol. Last week, the FDA sounded an alarm on farm-raised seafood from China, citing excessive levels of antibiotics and additives.

"So far the extent to which tainted crops such as rice, fruits and vegetables exported to the US has not been determined. What is clear is that in contaminated areas dotting

the country, residents have been eating such food for years or decades.

"Pingyang, where Mrs. Lai lives, is among the so-called 'hot spots' in China where farmland lying in the shadow of factory smokestacks or mining operations has been contaminated by heavy metals. These elements can cause a sweeping range of health problems, from brain damage to cancer.

"Chinese academics have written about such sites in more than a dozen studies over the past two years in Chinese and international scientific journals. In a study published early this year researchers at the Guangdong Institute of Ecology found excessive levels of cadmium and mercury in Chinese cabbage grown in Foshan, a major manufacturing centre in southern China. Last year researchers at Lanzhou University published research showing that vegetables at far sites in the Northwestern Gansu province contained high levels of metals, especially cadmium, which is found naturally in the same sedimentary rocks that contain plant-friendly zinc."

A Great No-no Disregarded: Mixing Organic and Industrial Waste

"Rudimentary sewage treatment systems throughout much of China mean that organic waste is routinely mixed with industrial waste. When sewage is recycled into fertilizer, it may contain large quantities of metals and other industrial waste.

"With small patches of farmland sprinkled among multistory apartment buildings, Pingyang is a testament to the urban sprawl that has blurred the lines between China's countryside and cities. Residents plant green vegetables next to construction sites. Corn rises behind factories.

"In 1965, the local government built a smelting factory for lead and antimony, a metal used in fireproofing electronics and other applications. For decades, the factory discarded waste in piles near farmland. Rains would wash the metals including cadmium, a lead production by-product – into farmers' fields and into the ponds the farmers used to water their crops.

"A senior official with the environmental agency in nearby Nanning, who declined to give his name, said his agency began testing the soil near Pingyang's smelter in the 1980s. After confirming the ground was contaminated, his agency reported the

problem to the local government and suggested shutting down the smelter. Nobody listened, the official says.

“July 15, 2007, doctors from the Guangzi Institute of Occupational Disease Prevention and Treatment in Nanning came to the village early this decade and tested dozens of villagers including Ms. Lai. Dozens were found with poisonous levels of heavy metals, and doctors gave them medicine they said would help clear the metal from their bodies. The doctors told Ms. Lai that the metals failed to discharge the metals from her body completely. The government tore down the factory in 2004. The orange trees in the village are already growing better, she says, but the health problems have persisted.

“Xia Cheng, deputy director of the agricultural service centre says the agency cleaned much of the mine residue a decade ago, but it advises farmers not to plant there, and pays them a small amount in compensation each year. Still, Mr. Xia says, villagers grow crops on contaminated land. ‘The land is owned by farmers,’ he says. ‘We can’t go to cut the crops off.’

“A strange permissiveness for a government agency in a country that still imprisons its citizens for thinking dangerous religious thoughts.”

We want none of the end results of such misplaced liberalism imported to Canadian stores and tables.

“Over the past five years, the Chinese government says it has increased its testing of food exports for heavy metals, but there are still gaps. ‘It’s very difficult for the authorities to check every batch,’ says Chen Junshi of China’s Center for Disease Control and Prevention.

“China’s soil is also compromised by waste from thousands of private and public mines that dot the country. Last year, a group of Chinese scientists published a study that found the soil and vegetables around an abandoned lead and zinc mine a few hours outside of Shanghai was contaminated with heavy metals. It’s not clear when the mine was in operation, but the local environmental protection bureau says that historical records indicated it was in use during the Qing dynasty, which ended in 1911. Slag that the miners had excavated from the mountain was left in piles near farmland, allowing rain to wash the metals into nearby fields. Tests showed the zinc level 20 times higher and cadmium levels 30 times higher than the minimum heavy metal concentration allowed under China’s national and soil-quality standards.”

Lead — The Murderous Guest who Won’t Go Home for Millennia

“Heavy metal residues stay in the soil – cadmium for decades, lead for tens of thousands of years – so fixing the existing problem won’t be easy. One of the shops that buys rice from farmers and sells it to locals is Sunshine Grain & Edible Oil Centre, in the nearby town of Shangyu. ‘Rich families buy rice from other provinces from northeastern China, because of its better

quality,’ says Ren Qinghao, a 42-year-old shopkeeper at Sunshine Grain. ‘Poor families buy local rice.’

“In the US some public health officials worry the government is not testing enough imported food for heavy metals. ‘It’s less stringent than Germany or Japan,’ says Rufus Chaney, a research agronomist at the USDA. ‘It’s the luck of the draw, not preparation, that has protected us.’

W.K.

Some Thoughts on an Opaque Subject — Money

“What is money about? What are its functions? What is it called on to do?”

It has several purposes. Let me mention the most important. Before it was developed the exchange of goods between different tribes or individuals took various forms – even religiously inspired gifts between tribe and tribe. But the most common was barter which means that A had to want what B had and be willing to exchange one type of good for another. Failing that, he had to accept whatever B had and find somebody who needed and wanted the B good.

Hence money’s first and basic value would have been as *medium of exchange* – a bridge to the eventual exchange of two goods, that were not desired by the two potential buyers who originally confronted each other.

But time might elapse before B really had need for the B good or any other good at all. The A good may have been a fruit or vegetable with a short life. And that then rots. Hence the next function of money asserts itself: *a store of value*. No matter what is chosen as money it must withstand the passage of time and preserve exchange value until it can be used. Our hero in the last example, would sell his tomatoes before they rotted, and keep the money until he needed something else. Hence its second function of money is as *a store of wealth*.

To exchange two goods, we must be able to measure their prices and hence their approximate values. That is a third function of money: *as a measure of price and value*. Price is the quantity of whatever serves as money actually obtained or obtainable in a transaction. Value is a more theoretical view of what it might or should obtain in a transaction.

Having gotten these relatively simple functions of money more or less out of the way, we move to the very essence of money

that is still not very clear even among economists. Most economists and politicians believe, or pretend to believe, that money is gold or silver, or something else that one can run out of. In actual fact that is not the essence of money. It is not any particular sort of commodity – at one time money was gold, or money was silver – that the belief in such commodity money lingers on, partly because they may remember when it was gold or silver that countries could and did run out of supplies of. In such moments – usually during wars or other great crises, governments supplemented their lack of the money-commodity with paper money – a commitment of the government to redeem that debt with payment of the money commodity at some later date, with interest (in the case of bonds) or without it in the case of money, but that was still not money reduced to its essence. Clearly it was not the money-commodity per se that filled the function, because long before paper money took over, monarchs exercised the privilege (*“seigniorage”*) to change the precious metal content of the gold or silver coins. And that was not always just dishonesty or trickery, but a convenient form of taxation. At a time when the supply of precious metals was inadequate – say before the discovery of America – and in a largely illiterate society only the merchant class ever had enough money to pay their taxes in money. Most of the illiterate population paid in military or agricultural services for their feudal lord. And the monarch recalling the coins, melting them down and then recoinning them with less precious gold and silver, affected almost entirely the merchant class, that alone had the literacy and the wealth, and a dependence on the market to pay their taxes in coins. The majority of the population did so by service amongst the lord’s soldiery and

by toiling in his fields.

So let us put the matter of money and specifically bank money into a different perspective than commodity money that consists of gold silver, mussel shells, that have some other usefulness, real or imagined, other than as money.

Distances Enter the Equation

When trade and other relationships ceased being purely local, and took place over long arduous distances, other functions of money became crucial. When the Roman Empire had crumbled, the roads it had built stayed on but no new ones were being built and nor were the old ones properly policed or maintained. The state has crumbled into many principalities, many little more than tiny gangsterdoms. But trade eventually started reviving. Merchants accompanied their goods across seas and continents. The roads were infested with brigands. It was risky enough to travel with their goods. But taking gold and silver coins along with them for purchases, or returning with gold and silver from making sales would have been inviting robbery and a slit throat. So a merchant returning to Holland after delivering a load of wool for weavers in Italy would carry a note, usually from a goldsmith to another goldsmith, say in Amsterdam, who had in his trust let us say another goldsmith in Milan to whom the traveling merchant would deliver a “letter of credit” or something similar. Eventually a merchant traveling in the opposite direction would redeem that letter of credit and make good the money previously paid out by the first goldsmith. Of course commissions and interest would be charged and paid for such services. Eventually that corresponding goldsmith would receive a visit from some merchant who had come to Amsterdam to make purchases and, on receipt of the note instructing him to do so and, after examining the signature and seal, pay the merchant the money left with him who would use it for making local purchases to take home. The money was the most vulnerable item in these transactions. And hence it wandered as little from its home base as possible.

Now let us pause to see what these arrangements looked like to the goldsmith left with other people’s gold or silver. Those gold and silver coins lay there doing no one any good. Whether it was Lucifer or the Angel of progress, or both, who whispered into the gold merchant’s ear an obvious message is still not decided: “Why not lend it out? The rightful owner will never know the dif-

ference, and if it bothers you, you can share some of the interest with him and even have a mass said for his saint’s soul.”

Especially so when you take the rapidly expanding North American British and French into account. While Britain preached free trade, it hugged the coining of gold and silver close to its chest, and forbade the coining of precious metals in the colonies. Only Pennsylvania jumped ahead and, anticipating monetary reformists, issued its own paper currency. Almost a century and a half before the US Civil War in the British colony of Pennsylvania, Benjamin Franklin enunciated the usefulness of the colony issuing paper money, instead of waiting for arrival of ships next summer with a supply of British currency, while merchants went broke with their bills unpaid if bad weather held them up.

Similarly in the French colony of Quebec, during the long winter, bits of marked playing cards served to pay civil servants and merchants on time.

During the US Civil War the North under Lincoln issued \$450 million of Greenbacks which was paper money with no further backing than the credit of the government. Lincoln himself considered it strictly as an emergency war measure, but other individuals in and outside the government considered it a liberation from enslavement of the nation to the precious metals—a continuation of “the Pennsylvania tradition.”

Eventually the goldsmith pioneers whose activities we have noted grew bigger, bolder, wealthier and more influential. The ancestral goldsmiths had uncovered the important secret, that it was the credit of the government that was the essence of money, not the commodity cast in the role for a particular staging of the drama.

And in the twinkle of an eye, the essence of banking, the fractional reserve system had arisen, so obvious that it was almost self-invented. Was it wicked? Or was it good? Without such fractional reserve banking there would never have been enough gold and silver to support the commercial expansion that took place. Remember that that mining had been a lost art in Europe until it was rediscovered towards the latter Middle Ages in Germany. And even then there was not enough gold and silver mined. It was only when the Spaniards plundered the gold of the American Indians, and the British pirated a good part of that booty at sea that there was an approach to enough gold and silver for the expanding economy. So long as

the gold and silver coins could be delivered when requested to their rightful owners requested that such “commodity money” or the promise of it turning up when required was a progressive new institution. Whenever a banker failed that test he risked having a hand chopped off in many countries, and one banker in Barcelona who failed the test was actually beheaded outside his bank. Only monarchs could get away with it. Famous banking houses like the Medici of Florence were ruined because the loans they made to monarchs were not repaid when due.

Each goldsmith or rudimentary banker worked out an empirical formula of how much of other people’s money he could lend out and for how long, without running into serious trouble.

The multiple by which the banks could lend out the legal tender – the official money of the country in question that had to be received in payment of debt, and were accepted by the government in payment of taxes – was known as the “bankers’ multipliers” and was faithfully described in all university textbooks on economics right until around 1991, when it was suddenly denied to exist in practice, not because it ceased to exist, but because it had grown so fantastically large, that it could not be exposed to the light of day.

The “Bankers’ Multiplier” — Supreme Temptation

The “bankers’ multiplier” was a dangerously tempting device. For example, one not uncommon strategy was for a bank to locate in a far off place somewhere in the mountains, where postal delivery – the only one that could be counted on in those days – would take a week or two to deliver. For a week spent on receiving the claim for the return of a deposit and another week for receiving the cheque could make a substantial difference in the interest that could be collected and the investments that could be made pieced together from depositors money into some long-term investment. Whenever a banker spotted a pool of cash or near-cash he found it hard not fantasizing on how rich he could become applying to it his skills with the “bankers’ multiplier.” And in the twenties, when President Calvin Coolidge had “proclaimed that America’s business was business” political leaders mistook such tautologies for principles that had to be immediately acted upon. You have doubtless heard of Enron, the energy traders who ended up broke and several of

its commanding executives in prison. In the 1920s in Chicago it had as fore-runner in the person of a Samuel Insull who founded power trusts that ended in a smouldering heap of scandal.

Bankers greed grew with what they got

away with. Lending sums of money to Latin American corrupt dictators was a particularly popular investment. But when the dictators were overthrown, it was habit that could create problems. In any case the fact that bankers got into the stock market,

insurance, and real estate did not help, and before you knew it the stock market crash of October 1929 brought in a decade of depression which led directly to the Second World War.

William Krehm

Holding Back a Financial Hurricane with Pea-Shooters

The Wall Street Journal (23/07, "States Aim to Stem Tide of Home Foreclosures with Funds for Refitting Financing" by Thaddeus Herrick) reports an incredibly disproportionate response to a financial tsunami: "Hoping to slow the quickening pace of home foreclosures, about a half-dozen states are setting up funds to help homeowners with high-risk subprime mortgages refinance to more affordable loans.

"The states, which include Maryland, Massachusetts, New Jersey, New York, Ohio and Pennsylvania, are expected to invest a total of more than \$500 million in the effort. That isn't much, given the size of the problem, but state officials hope it will be enough to keep some vulnerable low – and moderate-income neighbourhoods from sliding into decline.

"Some of the programs will be similar to existing government lending programs, in which the state extends mortgages to homeowners and then and then sells those home loans, in some cases to companies such as government-sponsored mortgage-funding giants, Fannie Mae and Freddie Mac. The state then recycles the proceeds from the sales to make additional loans.

"New York Mortgage Agency officials say they expect to announce a \$100 million program in the next several weeks that would help an estimated 500 owners.

"More than one million American loans are expected to enter foreclosure this year. The total represents about 2.3% of the nation's 44 million of home loans, according to Freddie Mac, which bases its estimate on data provided by Mortgage Bankers Association, as Washington-based trade group. Freddie Mac says about 60% of these carry subprime mortgages made to borrowers with shaky credit records. The projected foreclosure rate – higher than during the oil bust of 1987, but not as high as in the 2002 recession – poses a significant threat in the housing sector and possibly to the nation's economy, if it spurs consumers to maintain a tight grip on their wallets. 'Falling home

prices hurt consumer spending,' says Patrick Newport, an economist in consulting firm Global Insight.

"The problem can be traced in large part to consumers who took out adjustable mortgages that had low initial rates but which adjusted higher after two years to a rate that was significantly above what they expected or could afford. Many of those consumers weren't aware that the initial mortgage rates on such loans are tied to long-term interest rates which haven't changed much in the past several years. But adjustments are tied to changes in short-term interest rates which the Federal Reserve has boosted 17 times since 2004."

What is the Fed supposed to be doing – alerting the public to the pitfalls largely of its own devising, or making it easy for the mortgage arms of our large banks to sneak up on their victims in the semi-dark?

"For example, a borrower who took out a \$300,000 ARM (Adjustable Repayment Mortgage), at 7.32% in mid-2003, would have had an initial monthly payment of \$2,060.73. A typical adjustment would have pushed that payment to \$2,692.63 this year, says Keith Gumbinger, vice-president of HSH Associates, a New Jersey publisher of mortgage-rate data."

Putting Entire Neighbourhoods at Risk

"That trend has put entire neighbourhoods at risk. Houses left vacant as a result of foreclosures tend to push property values down and cause neighbours who can sell to do so. Congress is considering legislation that would allow the Federal Housing Administration to help low and modest-income buyers, among other things, offering overstretched homeowners 40-year loans that would lower monthly payments. But much of the effort is playing out at the state level.

"You've got local politicians responding to local problems, and because the problems are bad enough, they are not going to wait

for the federal government to provide the solution,' says Kurt Pfothenauer, senior vice-president for government affairs and public policy for the Mortgage Bankers Association."

That is exactly the case with Mayor David Miller's dilemma in Toronto in threatening to shut down a new branch of the city subway, to get the attention of the provincial government that has a general election scheduled not too long ahead. The source of the trouble, however, lies with the federal government that has milked the Bank of Canada and the federal government to repeatedly bail out our deregulated banks. So it ends up as a diversion pointing the heavy artillery at quite the wrong target.

"Even so, the state response has been somewhat limited in scope. Of those who qualify, some are likely to be people who could refinance through private sector lenders. The recent flurry of plans is likely to make less of a difference in regions such as the Midwest, where workers may be unemployed [because of a sagging economy]. For its part the Massachusetts program sets aside a risk-capital pool to cover 25% of the losses from the program, something of an insurance policy.

"Borrowers must be no more than 60 days behind in their monthly payments to refinance into the 30-year loans at fixed rates of about 7.75%. As in other states, eligibility is restricted to borrowers with a household income that doesn't exceed certain thresholds – 135% of the median income of the Boston area."

Yet if we stop at the closest transmitter of the policies that led to the housing foreclosures, we will not come remotely close to dealing with the real sources of the trouble. In our legislatures, our universities, and our media, we must have an untrammelled discussion of our history that led up to the emerging mess. The problem must be attacked at its roots or it will live on and continue devouring our society.

W.K.

Does Union Always Mean Closer Together and Never Further Apart?

The confrontation between the head of the European Central Bank President Jean-Claude Trichet and the new President Nicolas Sarkozy reminds us that international unions do not necessarily bring nations closer. We do have much history to warn us on the point, but history is like a cute librarian who tends to keep the deeper truths safely on the bookshelves, and more than occasionally manages her budget with a bit of whoring on the side.

After the American entry into the affairs of Europe to turn the tide of WWI, and Woodrow Wilson's evangelism of the League of Nations, Washington was notable for its absence from that body. It was left to the higher diplomacy of the almighty dollar instead with deplorable results.

John Maynard Keynes who seemed conceived and born to sum so much up in terms that reached beyond the purely economic, remarked that people should move over frontiers with the greatest freedom but that goods we consume should as much as possible be homespun.

Not so many generations have elapsed since most of the world's inhabitants were tribal peoples, not only with their own languages and cultures, but with economies kept in negligible contact not by trade restrictions by primitive means of travel. And then when the masses began crossing oceans countries developed according to two different patterns: some as migrating countries to get rid of their excess population, and other – lands of immigration dependent upon foreign newcomers for the renewal of much of their labour force. And though much of what was learned by depending largely on immigrants has been forgotten, much of it does remain lodged in the perceptions and politics of Americans and Canadians in ways that Germans never learned. That is creating special problems for countries like Germany and France with aging populations – as eventually it will for Russia where alcohol is proving a powerful substitute for the mere calendar in hollowing out the active population. In Germany and Britain an aging population has created a tremendous dependence on Muslim immigrants for the hard physical unskilled work, and on the younger French generation for the skilled work and professions, with the even more

dangerous contrast in the native work force, between those who have been employed for longer periods and the later born. Those natives just entering the labour force are being treated a bit like native immigrants.

France's Native Immigrants

With sensitive social situations resulting from these conditions, it should be apparent that a central bank of the European Union that removes the power of the individual members of the European Union to run up more than a 3% imbalance of their budget – even when capital spending is not always recognized as such, and gives priority to “keeping inflation in check,” even when most of the members have been involved directly and indirectly in wars, has its perils. But let me quote from *The Wall Street Journal* (25/07, “Trichet is Put to the French Test” by Joellen Perry): “France's bid for influence over decisions of the European Central Bank has put President Jean-Claude Trichet in the hot seat as rarely before. Economists and central bankers say he is well equipped to defend the bank's independence. Nearly half way through his eight-year tenure running monetary policy for the 11.6 trillion euro zone, the 64-year-old Mr. Trichet has already proved that he has the political skills to battle Nicolas Sarkozy, France's barnstorming new president. He has also shown he is willing to tough out top-level criticism of his inflation-focused monetary policy for the ECB.

“A mining engineer and economist by training, Mr. Trichet has squelched public revelations of dissent on policy from within the ECB's governing-board since he took over the presidency in 2003. The board includes national bank chiefs from the 13 countries that share the euro, from slow-growing Italy to booming Ireland.

“Since Mr. Sarkozy's election in May, he has badgered the ECB and insisted the president should have more say over the bloc's exchange rate policy. Mr. Sarkozy – the leader of the Euro zone's second largest economy, and riding the wave of an electoral mandate – has found little backing elsewhere in Europe. but his demands were well heard.

“Mr. Trichet also holds a lot of cards in his defense of the ECB's independence. His

tight focus on inflation is supported by most of the euro-zone countries, including the bloc's biggest economy, Germany. And he is backed by hard-to-change treaties that give the ECB more independence than the US Federal Reserve.

“Mr. Trichet is already riding high on the back of the euro zone's economic recovery. Gross in domestic product this year is on track to rival 2006's 2.7% high. Inflation has been in the ECB's preferred range of just less than 2% for 10 months.

“As governor of the French central bank in the 1990s, Mr. Trichet faced down attacks by political leaders – including former President Jacques Chirac – on his anti-inflation policies. When the ECB raised interest rates in December 2005 from 2%, euro-zone politicians and international institutions including the International Monetary Fund, howled that the bank risked squelching the bloc's nascent recovery. ‘We have been fully vindicated,’ Mr. Trichet said last month.

“Neither a larger than life presence like former Fed chairman Alan Greenspan, nor a professorial economist who leads the debate like Ben Bernanke, Mr. Trichet has a reputation for guiding decisions through diplomacy.

“Sill, Mr. Trichet faces a formidable opponent and some genuine concerns. Mr. Sarkozy has shown he is determined to make his mark in Europe. After seeing his call for greater government influence on the ECB rebuffed by Mr. Trichet and Germany, Mr. Sarkozy may now try a different approach, pushing for Europe's governments and the ECB to take a tougher line on China's undervalued currency. His aides have said that he will ask other eurozone officials to join the push.

“Many economists expect the euro, which yesterday hit record heights above \$1.38 to continue rising as the ECB increases interest rates and Euro-zone economy economic growth outpaces that of the US.

“Mr. Trichet signaled in June that ECB is likely to lift its key lending rate a further quarter point to 4.25% in September.

“Others say that the ECB should be more transparent. The Federal Reserve is accountable to Congress, while the Bank of England has its inflation target set by the

Continued on page 20

The FDR was Also Stricken by the Collapse of the Eastern European Common Market (CMEA)

“Within and Beyond the Age of Keynes” from Meltdown, Vol. 2, originally in Economic Reform, November, 2001.

We live in and beyond what might be called the Age of Keynes. Within, because the problems he devoted his life to must be solved anew, for his solutions have been buried in masterfully organized oblivion. Beyond, because the problems he wrestled with are overlapped today by a still more tangled web of circumstance.

Keynes arrived at his mature views late in life. In 1930 when the Great Depression was already under way, he published his *Theory of Money* in which he still held that the problem of insufficient demand could be dealt with by managing the rate of interest (a l’outrance).¹ A few years earlier he had dismissed Marx as an economist he knew to be “unscientific,” thus implying solid scientific credentials for the marginal utility doctrine he had cut his teeth in.² Yet in his *General Theory*³ he spoke of his sympathy for the labour theory of value. He had finally grasped the lack of a tie with reality of the accepted model that recognized no other value than the price of the latest transaction.

That might appear so to the individual trader engrossed in his current deal. As might, too, the view that a dollar saved is a sign of prudence. However, applied to society, he finally recognized in these homely maxims what he now called “the fallacy of composition.” That in itself was an emerging recognition of the need for applying *systems theory* to economic problems. Of that COMER today, it would seem, is currently just about the sole proponent. A couple of decades ago things seemed very different. Systems theory, long used by engineers and scientists, seemed to have acquired champions in the economics departments of a growing number of universities. Since then, however, the big brushes have swept unorthodoxy from economic faculties and reinstated the exclusive rights of the self-balancing market. The two approaches are, of course, incompatible.

With Keynes’s recognition of some of the great traditions of economic thought, society had finally been dealt a hand at the table. Too many dollars saved rather than spent can bring on a lack of markets, mass unem-

ployment and bankruptcies. And when that happens, the government must spend more than it takes to fill the gaps arising from compensating for the original withdrawal of private purchasing power.

Keynes began the journey that finally brought him to Keynesianism as a participant in the peace negotiations the after World War I. His further attempts to deal with the neglect of political and economic problems between the Wars were both deeply frustrating and educational. During World War II, he advanced some of the most promising schemes for reining in inflation during wartime scarcities – forced savings to be released after the war as production caught up with civilian needs. Though his advice was but marginally taken, it became perhaps the dominant influence on Western thinking until the mid 1970s.

The Belated Education of J.M. Keynes

To acquaint ourselves better with the setting I shall quote Charles Kindleberger.⁴ The peace talks had fixed no figure for the reparations from Germany. That left the world monetary system upended.

“Viewed from the 1980s, the attempt to exact reparations from Germany makes little sense. A Reparations Commission in 1921 had brought forth a figure of \$132 billion gold marks.

“That imparted an aspect of improvisation to the entire first decade of the peace. Economists and statesmen vied with one another in displaying ignorance of what money is about; and concerning the gold standard and to what parities it might, if at all, be restored. Successive German regimes had little motivation for putting their fiscal house in order. They were determined to prove that reparations were simply not feasible.

“There was precedent for such a course. Germany had obtained 5 billion marks from France in 1871. Britain had led the victors at Waterloo in exacting 700 million francs from France after 1815. Now the French, having paid twice, were ready to receive. They turned down the proposal to use German labour for reconstructing their devastated North. Their construction industry wanted the orders.”

Most of the financial experts who advised

governments were not even aware of the transfer problem – reparations from Germany could only be in German marks unless you allowed Germany access to the victors’ markets on an unprecedented scale. Keynes pilloried that ignorance in his “Economic Consequences of the Peace” (1919).

Inflation in Germany gave way to hyperinflation due to several strongly negative events – the French-Belgian occupation of the Ruhr industrial basin, the French government’s refusal to revise the reparation schedule of May 1921, the report of an American bankers’ committee stating the impossibility of making a loan to Germany so long as the reparations were not scaled down, and on June 22, the assassination of Walter Rathenau, the German Foreign Minister. A general strike was declared; virtual civil war raged. The exchange rate went from 275 marks to the dollar in May to 370 in June. By June 1923 it was 16,667. That hyperinflation had the delayed result of making it difficult after 1930 to fight deflation in the midst of depression. “The collective memory of the devastation caused by inflation furnished those who believed in putting the economy through the purifying fires of deflation with inexhaustible ammunition against even moderate monetary and fiscal expansion.”

Each Allied power had its own priority in combining solutions of the reparations, the debt, and the currency problems. “French policy was to ‘commercialize reparations,’ i.e., have Germany borrow the money to pay off its obligations to France. Washington refused to accept reparations from Germany, but wanted repayment of its loans to the Allies. The British held they had no choice but to collect the debt owed them to the limit of the what the British owed the US.” In addition to all this, the outstanding issues of war debts and reparations raised transfer problems – finding the foreign currencies for all these settlements. These were exploited by Washington as leverage for other ends such as pressuring Britain to stabilize the pound in 1932.

This brought to the fore almost every aspect of monetary theory, many of which had never before confronted economists. Thus “the election of a Social Democratic government in Sweden in 1932 had led to

a 1933 budget adopting the Danish device of dividing the budget between current and capital expenditures.” Even today the US and Canadian governments, each in its own way, have only recently smuggled in just enough of this basic accounting principle to impress the bond-rating agencies.

“All portions of the political spectrum associated exchange depreciation with inflation because of their close tie in the early 1920s. Anyone who recommended devaluation was almost in danger of his life.”

When Deflation was Mistaken for Stability

The leading Marxist theorist and former Social Democratic German Minister of Finance, Rudolf Hilferding, asserted in a debate with the trade union leader, W.S. Woytinski, that “it was insanity for London to imperil her role as economic centre of the world [by devaluing the pound in 1931]. He predicted increased unemployment as a result of depreciation.” In answer to Woytinski’s correct prediction that Britain’s credit would be stronger and that others would devalue, increase their exports, and reduce their unemployment, Hilferding had only one answer: “Nonsense!”

The German Bruening cabinet was openly deflationist – cutting salaries by 10% – to balance the budget. William Lautenbach, an official in the Economics Ministry, had a plan for expanding bank credit for public works by several thousands of million Reichsmarks. The head of the Reichsbank, Hans Luther, argued them all down. But the main point was that Bruening had adopted deflation as a means of getting rid of the reparations. His detractors suggested he was a tool of the Reichswehr having just been put in office by Kurt von Schleicher, the army head, two weeks after the ratification of the Young Plan in March 1930 and removed on a thin pretext of agricultural policy in May 1932. That, significantly, was six weeks before the Lausanne Conference that effectively ended reparations. Three billion marks of German debt was issued at 100 to the Bank for International Settlements, which was to sell them on the open market after three years, but not below 90. Any bonds left unsold after fifteen years would be cancelled.

“The contrast is with the gold bloc and Japan. After the fall of the pound, speculators began selling the yen. Within three months, the Bank of Japan had lost 625 million yen in gold, suspending the gold standard in on December 17, 1931. What

followed was one of the most brilliant combinations of fiscal, monetary and foreign exchange policies the world has seen.

“During the 1920s a small minority opposition had campaigned against the restoration of the yen to par, holding out for a lower rate. Led by Tanzan Ishibashi and Kemekiki Takahashi, a distinguished journalist, it had fed on the views of Gustav Cassel and later of Keynes of the *Treatise on Money*. These works did not anticipate the theory of public spending, but they impressed Ishibashi with their advocacy of a managed currency.

“The journalist Takahashi was initially critical of the theories of Korekiyo Takahashi, the former prime minister and minister of finance in the new cabinet that took power after the fall of the yen.

“But the politician Takahashi [no relative of the journalist of the same name] intuitively understood the potential of deficit financing with a flexible exchange rate. His writing of the period showed that he had already grasped the mechanism of the Keynesian multiplier, without any indication of contact with Keynes’s student R.F. Kahn or his memorable article on the subject in *Economic Journal* of 1931. The balance of payments was protected not only by the flexible exchange rate, but also by the foreign exchange control laws of July 1932 and March 1933. The Bank of Japan lowered discount rates from 6.57% to 2.29% in April 1936. The Bank of Japan’s fiduciary issue [i.e., unbacked by anything but general government credit] was raised from 120 million yen to one billion. But the primary reflationary mechanism was government spending. Under Takahashi’s finance ministry, central government expenditures rose 20% each year of 1932, 1933, and 1934, and all in all from 31 to 38% of net domestic product. Sufficient to produce recovery, this, however, failed to satisfy the militarists, who wanted unlimited military spending. In consequence they assassinated Takahashi, aged eighty-one in 1939 – an ominous pendant to the murder of foreign minister Rathenau in Germany a few years before. The Japanese share in imports of the Netherlands East Indies rose from 12% in 1930 to 31% in 1933 when the Indies took protective measures.

“Gradually all this policy flailing came to focus on governments seeking the lowest exchange value of their currencies for competitive position in international trade. During the London Conference in 1933 the dollar firmed from \$4.12 to \$4.02 to the

pound and the American commodity and stock markets declined.” The competitive position of the US urgently needed a weaker dollar – the world was entering a period of ‘beggar thy neighbour.’ In the US exporters’ lobbyists were calling for 43% cut in the exchange value of the dollar. “On July 3 when prices had risen to 130, Roosevelt released a pungent message that drove a nail into the coffin of the conference. It concluded: ‘Our broad purpose is the permanent stabilization of every country’s currency. When the world works out concerted policies to produce balanced budgets and living within their means, then we can properly discuss better distribution of the world’s gold and silver.’”

Japanese Policy Comes Into Brilliant Focus

“Roosevelt, who loved discoursing on American diplomats being no match for the wily Europeans, was leading the US back into its shell to work at pumping up domestic prices and stock markets to secure a greater competitive edge. The British empire concentrated on building a sterling trading area. The gold bloc concentrated on what defences it could. The pound soared to \$5.13 by the autumn.

“And Roosevelt retired into the murk of amateur explorations of other ways of skinning the cat. His good neighbour, Henry Morgenthau, also Secretary of the Treasury, was with him holidaying at Campobello, and while returning to Washington on the *Indianapolis*, showed the president charts prepared by Professor George Warren, a Cornell agricultural economist, The charts purported to show from prices during the Greenback period from the Civil War to 1879, a connection between the price of gold and the price level. But the connection between prices and gold was not as direct as Warren seemed to think, but went through the exchange rate. The theory assumed a fixed price of gold in London, but as a commodity, prices of gold varied with demand and the opening of new mines.”

Some independent variables had been ignored.

“Roosevelt, however, was impressed and a week later informed Morgenthau that he would like to buy gold on the open market in an effort to raise commodity prices.”

What ensued reads like farce. “Beginning on October 25, Morgenthau, breakfasting with Roosevelt in his bedroom, set the price higher each day by amounts that varied arbitrarily. Morgenthau reported that Roosevelt

once proposed raising the price 21 cents because that was three times 7, and 7 was a lucky number.

“In no event is it likely that world economic recovery could have been accomplished by truces in the fields of tariffs and exchange depreciation.”

Though diplomatic talk was of coordinating the gold price of all currencies simultaneously, that missed the point. There were, in fact, many points. To re-inflate the American economy, Roosevelt was seeking a competitive advantage over other countries by raising the price of gold. If the exercise were joined by all, there would remain no competitive advantage for American trade, other than the higher value of American gold stocks.

Hoping to Stumble into Recovery

“But the Democratic administration was prepared to experiment until it stumbled into recovery on the home front. That never came to pass. The so-called ‘Roosevelt depression’ bit deep in 1936, and showed the economic improvement up to then to have been due to inventory accumulation in anticipation of higher prices. Washington had little interest in or knowledge of the world economy. It would be three years before the administration felt responsibility for or interest in the international economic system.

“The upturn from the depth of the depression began in 1933, but it was neither widespread nor rapid. In particular the world economy lost its cohesion. The gold bloc sank further into depression. Germany and Italy of the Axis pursued independent policies, cut off from the world economy by a system of controls. On the other side of the world Japan was recovering with speed and verve. The British Commonwealth, together with a number of other countries linked to sterling, turned inward along its own recovery path. In 1935 the recovery slowed to barely perceptible gains.”

Internationally, it was the rearming of the Axis powers and Japan that was the most dynamic factor. With the relapse of economic theory to pre-1930 levels, rearmament was the lone dynamic factor in accepted government policy for economic recovery. In that there is a disturbing resemblance with the situation today. And with the added detail that military technology at the beginning of World War II was largely at the horse-and-buggy stage. Much of the German artillery involved in the fall of France was still horse-drawn, whereas

Washington combines horse-drawn economic thinking with space-war. technology, while TINA – “There is no Alternative” – is in full control of economic thought in our universities, media and parliaments.

“In Germany unemployment was attacked through conscription (March 1935), the development of para-statal bodies, such as the storm-troopers and the SA, and especially in spending on rearmament and public works like highway system serving as well as infrastructure for war. The effect was to reduce unemployment from 6 million in October, 1933 to 1.2 million by February, 1937. German clearing arrangements with Latin America succeeded in bringing trade back to almost the 1920 levels. With Western Europe, the Commonwealth and North America, it remained at a low level. In short, world recovery in 1934 and 1935 was limited and fragmented. It excluded the gold bloc.”

The parallel with the state of the world economy today is chilling. Basic to this is the shattering of the world economy into currency blocs with limited, asthmatic intercommunication.

The Paradoxes of Keynes

Today anything that smacks of Keynes’s teachings, real or imagined, is blocked or buried. Constitutions are revised to ensure that he remain demurely under his tombstone. His spell is explained by his personality as much as by his doctrines. For sheer analytical powers, there were others who got to the core of things sooner, and more deeply. But Keynes was the man bred at the very heart of orthodoxy who could scoff at the pious in their own tongue to challenge the suicidal greed of capitalism. He charted ways of manicuring its claws, of rendering it house-broken, and endorsed the views of his Bloomsbury friends about the ultimate ends of life and living. And while doing all this he showed a more commanding familiarity with the workings of the system than did its choirboys.

The difficulty in exorcising Keynes appeared with dramatic force in the events that led to the collapse of the Soviet Union, and its sorry sequel in setting up the succession regimes. There were enough parallel failures of the two arch-rival systems to warrant serious studies. But these have been in short supply. One such neglected work is Charles Maier’s *Dissolution, the Crisis of Communism and the End of East Germany*.⁵ From it I quote: “The German Democratic Republic (GDR) ran up 40 years of an actual existing

socialism, not in Russia or the Third World, but in a region that conformed to Marx’s predictions.”

Maier disposes of the view that the GDR carried forward ideas introduced by Hitler. There were some common traits – full employment, negative or low real interest rates. These were applied by Hitler for the Autobahn project and vast military programs.

“On the other hand the Allied authorities wiped out anything that could be associated with Hitler or Keynes, as did the Federal Republic of Germany (FRG) in the GDR after the unification of the two Germanys in 1991. Keynesian counter-cyclic public spending was adopted by the FDG to deal with a serious recession, but the Bundesbank remained in the saddle and typically kept interest rates 3% higher than those in the US.”

The Irresistible Allure of Keynes Resurfaces

“Chancellor Kohl of the FGR recognized that the East Germans had paid reparations to the Soviet Union on behalf of the entire German people, whereas the Western Allies had exacted no reparations from the FRG. On the contrary the FRG benefitted from Marshall Plan aid. Kohl’s perceptive policy turned out rewarding to the FRG even more than to East Germans. Keynes, proscribed and interred, was back through two windows rather than just one. A belated application of his arguments against reparations from the defeated that reached back to the Treaty of Versailles was united with an argument of the usefulness of enhanced government spending during recessions. The one-to-one exchange of Eastmarks for Westmarks was a gift to the East Germans, but the bonanza was spent largely for West German products such as automobiles that provided a much-needed boost to the West German economy. The Bundesbank finally contrived a less generous exchange rate for translating Eastern German savings and pensions.”

The FDR was also stricken by the collapse of the Eastern European Common Market (CMEA) due to the requirement that all international transactions be conducted in hard currency. The advantage of such a union as the CMEA, on the contrary, could have continued if trade between member countries had gone on in local currencies. Had this been respected, the deflationary collapse throughout the region could have been attenuated. Instead of low interest rates, the former GDR was suddenly

afflicted with high-rate Bundesbank policy. Maier fails to mention the negative effects of the obligatory military spending imposed on the GDR by Moscow. After 1977 when President Carter urged NATO countries to increase their military spending by 3%, Moscow responded with a 4% increase for its allies. Gorbachev, however, realized that the Soviet bloc was not up to continuing the arms race, especially when the proceeds from oil exports declined. Instead the Soviets cut back the subsidized delivery of crude to their allies, The high interest rates of the Bundesbank did the rest. Meanwhile, as though to keep in line, the older Western regimes like the FDR are reducing their social expenditures. And this is institutionalized in the restriction against deficits and “inflation” in the EU. Only France shows signs of falling out of step.

Without this lamentable background, the blood-drenched tragedy of Yugoslavia would probably not have happened.

A Multi-tiered World Economy Takes Over

The preponderance of the lone surviving superpower, the United States, has become so great that the balancing defences of lesser countries, and particularly the emerging and ex-colonial countries are falling under the mantra of Globalization and Deregulation (G&D). Not only is the world economy segmented, but it has become severely multi-tiered.

In the resulting trireme, the slaves, shackled to their benches, work the oars. There in the real economy, not only has “inflation” been licked, but deflation has since set in. But on the top deck, until recently, passengers wallow in every luxury while speeding

Season *continued from page 11*
tempted.

“Foreclosure rescue deals vary in execution, but as in Mr. Morris’s case, they capitalize on two things: borrower desperation and mind-boggling complex mortgage documents. A study published last month by the Federal Trade Commissioner found that documents were so confusing that 9 out of 10 borrowers could not identify up-front fees on mortgage loans and half could not specify the amount they were borrowing. Sam Finkelstein, an advocate for affordable housing, has encountered several variations of foreclosure rescue schemes. One program offered by RYM Technology Holdings, which is based in Birmingham, Michigan, lured at least 20 struggling local homeowners

to an uncertain destination. Ask no longer whether we have inflation or deflation. In the best of all possible worlds, we have both, properly ordered.

In a recent speech at Stanford University, Alan Greenspan, chairman of the US Federal Reserve, noted the unusual rise in the stock market but avoided anything resembling his warning about “irrational exuberance” issued in December 1996. The Fed, said Mr. Greenspan, focuses primarily on the prices of products and not of assets such as stocks and real estate (*WSJ*, 8/9/97). Yet, ever the wily survivor, he did slip in a bit of hedging with the remark that in the late 1980s Japan had demonstrated that soaring asset prices can undermine an economy even if prices of goods and services are stable. Mr. Greenspan is cunning enough to recognize that the banks, combining their powers of money creation with the new deregulation, have taken over brokerage houses and much, much else to become the preeminent makers and shakers in the world of financial mega-deals. Today they move and quack like brokerage firms rather than banks. And in this brave new world where everything stands on its head, the central bank, founded to keep the banks in line, has been reduced by its own doing to taking their orders.

So the Fed hesitated to raise rates because it would have pricked the hot-air balloon that the stock market and the economy as a whole have become. Since stock market winnings can be spent just like any other currency, they are in fact an inflationary expansion of the money supply. Yet this does not disturb the central bank. Monetarism, proclaimed the official Fed line in the late 1970s, holds that the money supply alone

ers and as many as 40 other people in Chicago, said Mr. Finkelstein, who is a housing organizer at the National Training and Information Center in Chicago that supports housing groups around the country.

“According to participants in the RYM Tech program, company officials promised that if the troubled homeowners signed over their property deeds to RYM Tech and made monthly loan payments as usual, in five years they would get their homes back free of any mortgage.”

Strange things done in stealth with interest rates at the highest level of the land, cannot help but filter down throughout the economy.

determines the price level and just about everything else in the economy. But even within the Fed this has long since been abandoned as a bad joke. With deregulation it is even impossible to say what the money supply might be. For example, credit cards are not included in the money supply, though they make up a main asset of many banks.

To justify the arrangement, the mass of our population has simply been cast in the role of consumers thriving on the cheap goods flooding in on us through the open gates of globalization. What is glibly passed over is that people come on stage as consumers only when they have found jobs. And Globalization and Deregulation have added the wretched of the Third World to the dead weight of the domestic unemployment to keep our commodity prices flat.

William Krehm

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4. Kindleberger, Charles P. (1973). *The World In Depression – 1939* (rev.). University of California Press.
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Union *continued from page 16*

British government. Both publish the minutes of their meetings and the breakdown of votes on each interest-rate decision, helping markets understand the bankers’ thinking. The ECB’s mandate, by contrast, specifies that it should avoid all political influence, while the rate-setting decisions are taken by consensus and no minutes are published.

“While Mr. Sarkozy is unlikely to dent the ECB’s independence, some observers say he does, in fact, have a shot at giving politicians more say in euro-zone exchange rate policy because of the wording of the treaty that established the ECB’s independence. ‘The treaty is ambiguous about who establishes the exchange rate,’ says Jacques Cailoux, euro-zone economist with the Royal Bank of Scotland in London.

“Using this loophole, Mr. Sarkozy is expected to try to get European politicians unified around a common currency policy and at a Group of Eight meeting of finance ministers in October, he could aim for a statement calling in China to let its currency appreciate. That is unlikely to sit well with Mr. Trichet, who has called himself, ‘Mr. Euro.’”

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