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Only a Royal Commission will Allow Our Broken-down Parliamentary System a Fresh Start

Sixty years ago Canada organized the Canadian Mortgage and Housing Corporation (CMHC) to allow every Canadian family to own the house it lived in. A key part of the process was making use of the Bank of Canada (the BoC). It had been founded in the darkness of the Depression in 1935 as an organization of private shareholders, but three years later all 12,000 of these were bought out for a good profit by the government. And a key part of the CMHC's activity was using the Bank of Canada to enable the government of Canada to guarantee the mortgages that the ordinary citizen took out to buy or build his home. Without government guarantee it would have been impossible for the private banks to enter the mortgage field. The risk would have been too great for the law governing banks to allow it.

It was the nationalized BoC moreover, that allowed the federal government to play a key part in financing the public infrastructures, water plants, roads, schools, hospitals, public transport that made possible the entire generations of home-owners that sprang up throughout Canada. For many of these the equity accumulated in their home was the principal saving they ever managed to do.

That publicly owned Bank of Canada had helped make it possible for Canada to finance her part in WWII at a cost of less than 2% in interest. The arrangement was simple enough. As sole shareholder of the Bank of Canada the interest paid on the federal government debt held by the BoC came back to the federal government – less overhead costs – as dividends. It was that arrangement that made it possible for Canada to finance its war costs at a lower rate of interest than the US or Great Britain, where the central banks were still privately owned at the time. Yet even there much of the profits still found their way back to the central government as government *seigniorage* – the ancestral sovereign's monopoly in coining precious

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metal. By the banks' charter that had been translated into the banks being allowed to issue credit to a multiple of the reserves in their vaults. In the banking business this came to be known as the "bank multiplier" and amounted after World War II to about 10 to 1. Today it is closer to 400 to 1.

But at that time – by the terms of the *Banking Act* brought in by Roosevelt in 1933 after 38% of banks had closed their doors and a bank moratorium had been declared – banks could not acquire any interest in the other financial pillars – stock brokerages, insurance, or real estate mortgages. Such investments were too risky to mix up with the Bank multiplier of the day. Banks were also limited in the interest they could pay or charge. The US *Banking Act* pretty well came to serve as an international model for legislation in non-Communist lands. Restricted to banking, and very much in the doghouse for their responsibility of having brought on the 1929 stock market crash through their irresponsible gambling, the banks gradually were nursed back to health.

Banks Came Back with a Vengeance

With solvency, they came to experience the old itch for speculative glories. But elected governments had promised a fairer world than that of the 1930s to their armies and to the civilians undergoing rationing and toiling at war production. Those commitments made by elected governments meant that the banks' comeback had to be organized outside elected governments and to an extent *against* them. This required a semi-underground command post for the planning and execution of the comeback and the takeover of the world economies by the banks.

The requirement was met to perfection by the Bank for International Settlements (BIS) which had its own good reasons for cultivating the low profile required. It had been organized in 1929 to look after the syndication of the Reparations debt connected with the First World War. Germany could collect these only in marks, and France and Belgium would accept them only in a strong currency. Hence it had been set up to arrange for the syndication and transfer of the reparations from marks into dollars or other stronger currencies. But the crash of October 1929 ruled out such transactions. So BIS lived on to no great purpose, but meanwhile was able to offer the Hitler government some notable services, one of which has been perfectly documented. When the Nazi troops moved into Prague, BIS almost toppled over in the speed with which it surrendered to him the gold reserve that the Czechoslovak government had deposited with it for precisely such an emergency. As a result at the Bretton Woods Conference in 1944 that planned the postwar monetary system, Resolution 5 was unanimously adopted on the motion of the Norwegian Government-in-Exile to have BIS liquidated at the earliest possible moment. This explained the low profile BIS cultivated in succeeding years. That low profile in turn recommended it brilliantly as a semi-secret war room for planning and carrying out the banks' international comeback to be realized against the official programs of their elected governments.

It was as though in a master game of chess one side had high-jacked the king and queen and set them up on another unofficial chessboard on another table, so that the game went on with the master moves plotted and carried out off the board. Deprived of the King and Queen, the official players, of course, had no whiff of a chance of winning.

It was on that second board, that the purloined King and Queen made the master moves that condemned the central banks, whether publicly or privately owned, to turn their backs on the fruitful policies that served the world so well during the war and subsequent decades. The banks had been bailed out of their previous capital losses by being allowed to acquire the central government debt of developed countries without putting up any down-payment. They were also relieved of the need of depositing statutory reserves as a percentage of the deposits received from the public. But bank deregulation on its own momentum had proceeded further, and the question loomed how the next round of gambling losses of our banks would be covered. The answer has already come in recent months. The Canadian government has announced massive sales of key government real estate, with a 25-year lease-back to the government. Since France has come forward with a similar plan for outright sales of historic castles and other historic real estate, it is clearly a plan hatched from an international center, undoubtedly BIS.

The pretext is that some of these properties have a backlog of maintenance that the government cannot afford. But that is what mortgage companies and banks are for. Special drawing rights to catch up

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A Banker Regrets the Behavior of Banks

The following brief text comprises two recent postings by a veteran banker and monetary theorist to an Internet conversation among a small group of specialists. (Interested readers of ER *can find out more about the subject and its participants by entering "Gang8" in a search engine. Michael Hudson, whose work has been reported previously in this space, is one of them.) In this selection, Christopher Meakin provides some personal details along with his commentary on trends in banking and finance.*

Selected by permission of the author and very lightly edited by Keith Wilde.

It wasn't always This Way

I am appalled by the cavalier way the big British banks are now screwing their customers, in public, without remorse, without conscience.

It troubles me all the more because, 20 years ago, I was head of Public Relations (and in effect of Marketing also) for HSBC, duly based at its then-world HQ in Hong Kong. That was several years before it bought Midland Bank here in the UK, thus obtaining for itself a substantial footprint in the European retail banking market for the first time, and moving its world HQ to the huge building straight across the Thames at Canary Wharf which I am currently looking at out of my study window.

Prior to that I was European PR Director for what was then Chemical Bank of New York, based here in London. Nowadays that same bank has grown into JP Morgan-Chase. As it happens the current chairmen of both banks, until they move on, are thus personal friends, having worked closely with each of them before they ascended the final rungs of the corporate management ladder.

At Chemical, 1979-84, I consider I had the privilege of seeing the height of true courteous banking – high-tech for sure, we were the highest tech bank in the world – but still regarding the customer as king.

Yet from about 1990 onwards it has been downhill all the way. I am appalled what Stephen Green – a devout Christian believe it or not – is apparently condoning since he became Executive Chairman of the Bank last June, 2006. Stephen and I were the closest of friends at HSBC, and are still in contact – same university, same subject, even the same tutor in the leading British economist Walter Eltis.

I am not sure what can be done about the current unfairness and mess inflicted by the retail banking industry but I am powerfully reminded of the arrogance of companies like Standard Oil, and of Duke's tobacco empire, which led the USA in the early years of the 20th century to introduce its trust-busting laws.

Here in the UK we have a Monopolies Commission, we have a clutch of Fair Trading Acts on the Statute Book, but we also have a socialist government which is nevertheless craven to big business (which does not elect it) and wholly unwilling to stand up for the rights of the ordinary citizen/consumer (who does elect it).

It is strange, and really rather unpleasant.

Chris Meakin, London

Civilization Seems to Require Regulation

A second post from Chris Meakin on the same day, April 26, 2007:

It's a funny thing. Geoff Gardiner and I (former bankers both, he with Barclays which is about to tumble into bed with ABN-Amro) approach it from one starting-point, Kevin D. and James C. from a quite different and distinctly more socialist starting-point, yet we all seem to end up in the same place.

I am beginning to believe the big banks should be broken up, just as the trust-busters of the USA smashed Standard Oil into five regional chunks, and returned to their origins as regional, personal banks.

I am also beginning to think the USA was right with its *Glass-Steagall Act* which forbade retail banks from also becoming investment banks. While I think the American *McFadden Act* which forbade American banks from operating in more than one State was over-restrictive its heart was, it now seems, in the right place after all. Both Acts have been repealed by Congress since the 1980s.

I am also beginning to wonder whether we should not advocate regional banks which are trust-based, rather than limited companies which are profit distributing, to carry out the basic functions of retail banking:

- Holding accounts, taking receipts, handling payments;
- Moving funds from one account or location to another;
- Converting funds from one currency to another;
- Holding the savings of individuals, paying interest;
- Making loans to individuals, charging interest;
- Selling strictly financial services such as banker's drafts;
- Operating debit cards to do much of the above electronically;
- If they are still popular, running credit cards.

Such banks should be subject to a strict capital adequacy ratio. They would not be allowed to indulge in high risk, high profit activities. So they would not need avaricious shareholders. They would also be permitted to do business for private companies but only those with fewer than – say – ten shareholders.

They would be more like a continental Giro, and their overwhelming emphasis would be on individual service, and local people knowledge. As I was taught when I first went into banking "always lend to the man, never to the asset." That wisdom went down the tubes almost 20 years ago.

This is how the banks evolved in the UK up to the first half of the 20th century. Joint-stock banks were forbidden for a long time into the 19th century, and I now think with good reason.

Chris Meakin, London

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The Wild West Gone Global

The comments about British banking by Christopher Meakin on page 3 were supplemented on the same day by James Cumes (the "James C." mentioned by Meakin). Cumes' book America's Suicidal Statecraft *was published this past winter and may be ordered through Amazon, where it is also described. He is a former Australian diplomat, among other qualifications, which may be reviewed in a biography available by entering "Gang8" in a search engine. Excerpts from his book are posted to Gang8 from time to time, and he has given permission for their wider dissemination. The remainder of this text is by him exclusively, with the addition only of subtitles.*

Keith Wilde

Just like all the rest of us, the banks do as much as they can to boost their "take" and their power within the limits set by those who are supposed to "govern" or "regulate" them. If the government and its relevant institutions, such as a central bank, tell the banks and – even more importantly these days – the non-bank financial institutions, that they have open slather to grab whatever booty they can, from whomever they can and however they can, then that is what they will do.

There's a lot about this process in *America's Suicidal Statecraft*. To quote just one piece:

It was the gradual disillusionment with Keynesianism and then monetarism which, in Britain and then elsewhere, helped to lead policymakers through such concepts as privatization and deregulation to an overriding belief that the economy should be allowed to run ever more freely in accordance with market processes and that the banks should have maximum freedom within this free-market system. The sudden deregulation of banking, together with the floating of exchange rates (outside such devices as the European Union's Exchange Rate Mechanism) and freedom of movement of funds into and out of the economy, brought a dynamic instability with which the banking systems of all countries were and still are – from a macroeconomic standpoint – ill-equipped to cope. However, from the point of view of the banks – and increasingly of financial institutions outside the traditional banking system – the dynamic instability was just what they might have prayed for. It opened up such opportunities for speculative profit that they were not going to permit any interference by governments or central banks who might be inclined to meddle with it.

In many ways, consequently, the banking system reverted to what we might imagine to have been the unregulated conditions that had obtained much earlier in the century, or in the Wild West days of nineteenth-century America; but it did so now in a much more sophisticated and technologically advanced financial environment in which changes could be and were sudden, perhaps "globalized" and – potentially at least – terrifyingly unpredictable. Changes in market trends and situations could take place without reference to what might have been traditionally regarded as clearly identifiable economic "rules." More and more, stock markets, currency exchanges and other financial markets were moved by speculation and the emotions – the euphoria and anxiety – that nurture speculation. This was not new: speculative fever has played its part in the volatility of markets from the beginning of time. But the size and complexity of the markets distinguished the situation, from the 1980s onwards, from anything that had ever been known before.

The Realm of Money and Finance is Not What It Used to Be

Markets were now huge, modern and, in a very real sense, globalized. No longer were they local cattle or other commodity markets or even stock markets of the kind that had existed in New York at the time of the Great Crash of 1929. Now there was speculation in the domestic markets and across the national frontiers in a dazzling variety of forms, using an equally dazzling array of financial and trading devices. Almost anything could be "hedged" and, if it hadn't been "hedged" before, then as with credit derivatives in the past decade, there were plenty of inventive young financial operators ready and waiting to bring it within the scope of global markets without too much delay. In what was quite a rapid evolution – over two decades or so – these huge, varied and complex markets became so massive that they swamped normal trade and long-term investment transactions and converted a variety of exchanges into vast, twenty-four-hours-a-day casinos. The funds involved in the markets weren't counted just in billions; in aggregate, they were counted in trillions of dollars and going ever upwards. The evolution – or revolution – has not slowed or stalled and, in the middle of 2006, is racing ahead more rapidly and powerfully than ever.

The result was that, from the mid-1980s, economies bolted off on a wild bucking-bronco ride that, although stimulating as compared with the prudent regulation of the period between 1945 and 1970 and although bringing advantage to some, mostly in the short-term, was more than either private banks or official regulators could competently control. For some years now, most operators and regulators have been out of their depth, except – perhaps – in the very short-term trading day or week, with no idea what they should do, either in their own self-interest or that of the society, beyond – perhaps – the period immediately ahead.

Financial Buccaneering has Even Become Socially Acceptable

The characters have changed to some extent. The adventurers, marauders and buccaneers of the 1980s, associated with such devices as junk bonds, have been thrown unceremoniously to earth after their exhilarating ride. But others have taken their place. Speculation has continued to thrive. Not only has it become entrenched on a massive scale, but it is now much more, and more honourably, institutionalized. It is no longer at the margin. It moves in the very best of circles: it has become part of the mainstream way of economic and financial life. It is not just the high life of the successors to the adventurers, marauders and buccaneers but staple nourishment for ordinary, everyday, formerly cautious and often nervous citizens, including of course the fabled widows and orphans, representing the most vulnerable in the society. They may not know it but they're in there – right in the middle of the gambling parlour, sitting at the blackjack and roulette tables – with everyone else, their future dependent on a speculative frenzy whose outcome none of their advisers can, if they're honest, predict or control. In other words, speculation is now – whether they know it or not – much more a feature of everyone's normal, everyday economic life than in the 1980s or, indeed, than it ever was in the history of any human civilization, however dissolute, in the past.

In the 'nineties and since, speculation has come to be identified not so much with

individuals, although some have made massive personal fortunes from currency and other deals and have become celebrities as a result. The institutionalization from the 1990s onwards, taking the place of a kind of personality cult that tended to rule in the 1980s, entails much greater and more persistent dangers for the world economy and society. The tendency for such authorities as the Fed – and its Chairman – to give explicit blessings to widespread speculation has conferred on it a respectable status – a solid, John Pierpont Morgan kind of respectability. On the other hand, to the Cassandras, many national economies and the world economy as a whole now appear, at almost every moment, to be teetering on an edge of financial disaster. Even short periods of calm only precede, as they imagine, the ultimate cataclysmic storm.

But They will Crash, as They Always Do

Ultimately, the banks and non-bank financial institutions will go too far for their own welfare or survival. They will try to grab too much from constantly more "efficient" instruments for gathering in the loot and they'll destroy themselves – and oblige those who govern and regulate them to take back some – probably a mighty slice – of the freedom that they have misused.

This is not a possibility; it is a requirement in the ultimate analysis. If it were not – and were not seen as such – then the whole economy would collapse in a self-destructive, chaotic anarchy. We are pretty much at the point now at which this "ultimaticity" is/will be upon us. Records are being recorded pretty well everywhere in terms of peaks being reached and exceeded. There might be a little of the climb left to the ultimate peak but my guess is it can't be much and the time it will now take to reach it will be pretty short – months, not years.

A Great Crash has to have a Great Peak if it is to have a Great Fall; and a Great Peak is most assuredly reached – and the path to it is most felicitous for the happy bands of mountaineers – if they are allowed enough rope, not only to pull themselves up the mountainside but to strangle themselves with it on the way down. I suppose it must seem odd to an objective observer on a nearby planet that the human species should act in these ways. It *is* odd, of course, but that eccentricity – that capacity for a kind of narcissistic self-destruction – is inherent in the human personality and its consequent behaviour. That seems to be the case anyway. The data from the past – in so far as we can collect it – seems to suggest that what we have done before to bring misery on ourselves in financial and economic terms – and indeed in political and strategic terms – we are doing and will continue to do again – over and over and over again.

Nothing will stop us.

All we can do is prepare plans as best we can to pick up the pieces and try to fit them into some sort of survival kit when – quite soon – we find ourselves knee-deep in the smithereens of our own creation.

James Cumes

A New Stage of Automobile Overexpansion?

The wild overproduction of the automobile industry has brought yesterday's powerful concerns to the gates of bankruptcy. *The Wall Street Journal* (20/04) brought us two major articles disclosing new vistas of disaster for it. The first – "Passing Lane: GM's Chinese Partner Looms as a New Rival" by Gordon Fairclough – recounts how GM to postpone yesteryear's disaster entered into partnerships with Chinese companies that shared all technology in return for admission to the Chinese market. But as is the case with the entire gospel of relentless growth, yesterday's solution becomes tomorrow's nightmare: "Shanghai – Garment-company owner Li Xiangin was planning to buy a new Buick this month. 'Then I saw the Roewe,' a new Chinese-made sedan,' he said. 'It's quite a bit bigger and more luxurious and looks like a Jaguar.'

"Mr. Li's change of heart points to a challenge for GM in the world's second biggest car market. The Roewe's maker, Shanghai Automotive Industry Corp., has been GM's partner in making Buicks in China for a decade. Now the Chinese company, applying that know-how and the money earned from selling joint-venture cars, could become a serious competitor.

"GM says the bargain it made – access to the Chinese market in exchange for transferring technology and expertise – was worth it. 'We made a big bet back in 1997 and it's paid off for us very well,' says CEO Rick Wagoner."

The price: the tougher nature of the next decade of survival in competition with its partner, thoroughly schooled in the trade's secrets and now acting independently as a new competitor of GM as well as a partner. For GM's world-wide labour force this spells a further descent down the marble staircase to dubious pensions, employment and wage levels that brings us closer to the levels of our GM's Chinese hosts.

"GM's 50-50 joint venture which also makes Chevrolets and Cadillacs is the biggest car-maker in China by volume, bringing GM hundreds of millions of dollars in profit. That's a rare bright spot for a company that has trouble earning anything in its home North American market. GM is also a minority partner in a successful Shanghai Automotive-led company that makes minivans and cars in southwestern China.

"Still, the question lingers: did GM give away too much? Its Chinese partner could end up competing against GM both in China and abroad. Shanghai, owned by the Shanghai city government, already rivals GM in a joint venture with Volkswagen AG.

"Hu Maoyuan, chairman of Shanghai Automotive, says he wants to 'build a global Chinese brand.' His company, he says, 'will take full advantage of the technical and management experience we've accumulated in the GM and Volkswagen joint ventures.'

"Competition is threatening everyone's profits. Average vehicle prices in China have been falling at by about 7% annually in recent years. GM's profits from China operations in the final quarter of 2006 fell nearly 19%.

"The Roewe that Mr. Li plans to buy is no knock-off. Shanghai Automotive based it on plans acquired from the now defunct MG Rover Group Ltd. The project included British veterans of Rover along with Chinese engineers. The sedan's list price, about $30 to $36 thousand depending on options, is up to $7,000 less than that of the Buick LaCrosse made by the joint venture.

"Shanghai Automotive started production of the Roewe 750 four months ago at a factory in Jiangsu Province near Shanghai. It plans to introduce a new model every year for the next five years, building a range of cars from subcompacts to SUVs."

That will guarantee that there will be less and less space for the Chinese-American joint venture, especially for guarantees of continued success. Future plants are likely to move from the Shanghai area to cheaper outlying regions of the country. That, however,

will tend to ease the population pressures on Chinese society, unlike the globalized outsourcing of US and European industry.

That carries to a higher power the geopolitical advantage of the Chinese economy over that of the West not to be ignored in forecasting what the future holds in store.

Chinese Automakers — Wily Partners or Rivals?

"China's car market grew 35% last year, making it the fastest growing in the world in major countries. By 2010, the country may surpass the US to become the world's No. 1 market for cars and trucks.

"Other global car makers, banking on growth in China, are also seeing their local partners turn into potential rivals. Meanwhile, foreign companies are hampered by a Chinese law that says they must have local partners if they want to produce for the domestic market, and they can't own more than half of a joint venture."

Contrast this keen grasp of Western capitalism's weakness in its brainlessly short-sighted outsourcing largely for continued growth of speculative finance.

"Beijing is following the auto industry pattern in other high-tech industries as well. It is pushing foreign manufacturers of airplanes, power-generation equipment and electronics to share technical knowledge with Chinese partners.

"China's modern auto industry dates to the early 1980s when a government-owned company in Beijing signed a deal with American Motors Corp. to produce Jeeps, and Volkswagen went into business with Shanghai Automotive.

"In 1994, the Chinese government dissatisfied with the pace of progress, imposed stiff tariffs on imported vehicles and parts, and laid down requirements to speed knowledge transfer." That was right on the nose for coincidence with the outsourcing under NAFTA and other Globalization and Deregulation projects coming out of Washington.

"Toyota Motor Corp. [undoubtedly due to a better grasp of the thinking of Beijing and the realities of world trade], wasn't willing to play ball. GM and Ford were. After almost a decade of economic reforms, capitalism was beginning to create an urban middle class and the market for passenger cars finally seemed poised to take off. The two Detroit makers tried to outdo each other in their offers of technical cooperation.

"In 1997 GM landed a deal. It agreed to create a $1.52 billion, 50-50 joint venture with Shanghai Automotive called Shanghai General Motors. GM promised to customize vehicles for the Chinese market and set up a research and development center. Chinese engineers would work alongside foreign colleagues at the joint venture.

"In exchange, GM thought it would have protection from luxury-car competitors, says Michael Dunne, who worked as a consultant for GM at the time and now heads an Asian unit of research firm J.D. Power & Associates. It didn't work out that way. The year after, Shanghai GM started producing cars in 1998, Honda Motor Co. began making Accords with a local partner. More surprisingly, Shanghai Automotive began to produce the Passat, a sedan that competed directly with Shanghai GM's Buick New Century."

The 50-50 deal with Shanghai Automotive had been part of the strategy to lure the foreign producers to shed their technology for some much-needed short-term profits.

"In 2004 China's government added another wrinkle, pushing domestic manufacturers to build their own brands and not merely serve as partners for foreign companies. By 2010 China 'should become a major manufacturing country.'"

The joint venture gambit had served as a trap to get the foreign car companies to disgorge their technical know-how, and then face the fully empowered competitive muscle of wholly Chinese companies. Without the idiocy of Globalization and Deregulation dictated by the US financial sector, this would never have been possible.

"Today, the Shanghai General Motors Jinqiau South Plant, on the outskirts of Shanghai, builds Buick Regals with sophisticated equipment. The average car takes about 15 hours to build, about the same time as the best as at the best GM plants in the US. Japanese-made robots put windshields in place, German machines marry the cars' chassis to their bodies. Adjustable conveyors keep the cars within easy reach of workers in bright blue overalls.

"Last year Shanghai GM made more than 400,000 passenger cars. By 2010, the partners plan to boost capacity to one million cars annually. The venture already exports a small number of cars and GM officials say exports to developing markets could grow."

Whereas the usual outsourcing of production steps to cheap-labour lands leaves profits, high-reward design and marketing strategy at home, the Chinese have handled their strategy brilliantly. The Chinese will acquire major and eventually full control of such supreme rewards. Never mentioned in the discussions on D&G, it is, however – along with the job losses for North America and Europe – one of the key issues of outsourcing.

William Krehm

See also the article on page 20.

Some Canadiana Might Help Our PM Out of the Brambles

Going back a century ago, when Doukhobor immigrants, persecuted in Czarist and then in Communist Russia, began coming to Western Canada. Some found it hard adjusting to certain customs of their new country. Like sending their kids to public schools, to be taught all sorts of new stuff not part of their customs in Russia. But the law was the law and the RCMP was there to see that it was obeyed.

And some of the Doukhobors who didn't share the local prejudices – nakedness had been part of the state of innocence established by the Lord in Paradise, and it had the added virtue, that they knew it would rile the authorities, which they chose to do. So they took to demonstrating in the nude. And the RCMP, still undistracted with irregularities connected with their pension fund in those distant days, lost no time in giving chase to those who broke the law.

But soon the Mounties found that running in all their impressive uniform, didn't allow them to catch up with the Doukhobors who were sprinting as light as God had made them. So they took to stripping – first the helmet, then their tunics. That helped a bit, but not quite enough. The law-breakers still had an edge over the law-enforcers. So the stripping continued. Until they were really making progress.

However, by that time anybody watching the contest was bound to miss the moral point. All they saw was naked men chasing naked people. That is the dilemma of PM Harper trying to defend the record of the Canadian military in their treatment of the imprisoned Taliban captives handed over to the Afghan government for safekeeping, and we gather reeducation in the ways of democracy.

W.K.

The Scandal of the Federal Government Putting Up for Sale Key Real Estate that It will Never Afford to Buy Back Again

It is as though the press sensed that there was something rank about the Harper Government's big real estate sale, but they couldn't or didn't dare utter the real scandal involved. Thus *The Globe and Mail* (19/03, "Ottawa's real estate targets exceed market appraisals" by Daniel Leblanc) reported: "The Harper government is hoping to sell nine buildings for hundreds of millions of dollars more than recent market appraisals as part of its controversial plan to lease back the office space for 25 years confidential figures show."

But that is hardly the stuff of scandal. You can find such details almost every day in its Financial Section particularly in the latter parts of a real estate and income trust boom with REITs riding the crest. Besides overpricing properties put up for sale will usually be a self-correcting indulgence – the property will simply not sell, and that is what the market is supposed to be about.

But this, first announced in February is no simple market deal. For it comes with 25-year lease-backs of the office space by the buyers to the government attached. And since there is no mention of price adjustments not only to the price level, and the criticism of the article seems to be on an utter lack of adjustment of lease-back rentals over a quarter of a century period, it seem that we are to have more than 25 Christmases coming with the quarter of a century – at least as far as the buyers of the properties cum lease-backs are concerned. Just on the basis of the price level – let alone the downtown office space in growing capitals compounding at say 3% that will end up a wild bargain. Add to that the special appreciation of choice downtown sites and a 25-year lease back of the properties to the government, the web of underlying circumstances seems so dreadfully awry. And yet the one advantage of a minority government is that those in power are more vulnerable and accordingly less able to intimidate and repress. Unfortunately we do not have a minority civil service and it is the civil service that decided on the privatization of the CNR – under a distinguished former head of the civil service – and subsequent sales. In that way our government has taken a giant step, first for denying the existence of invaluable assets, and shedding them to bailout the deregulated speculative financial sector from future massive losses to come just as it has for those already suffered.

But there were in the earlier papers references to the need of the government to avoid massive spending to update the neglected maintenance of the building. But that cuts no ice. Even for a lesser covenant than that of the Government of Canada any mortgage company will include the financing of modernization, alterations that can be drawn only as the improvements committed to get under way. That is routine in the real estate and mortgage business. No need to sell the properties on 25-year unadjustable lease-backs. There is, however, the detail that the present boom of income trust REITs pass muster unchallenged. The reason? Downtown real estate in thriving cities throw off increasing revenue, as those communities thrive and downtown property in them becomes in short supply. Every bit of improved infrastructure, physical or human, makes crucial downtown real estate more precious.

A Cluster of Suspicious Circumstances

That is the first suspicious circumstance. But there is a further even greater one. The government, were it fool enough to finance the improvements of its key real estate with private banks and/or mortgage companies, would have no difficulty in finding appropriate mortgages to finance the necessary neglected maintenance.

But the government would have had no need for that. It is the sole shareholder of the Bank of Canada. The *Bank of Canada Act* in its subsections 14(2) and 18(c) makes clear that the central bank is free to trade in the debt of the federal government and can give the Governor should he refuse to hold federal (or provincial or corporation bonds which would include municipalities) that the Minister of Finance of the Government wished. Obviously if he wished to finance the proper updating of the maintenance of government buildings he would need only to instruct the Governor of the Bank of Canada in writing, and the government has 30 days or he is out. If it is financed through the Bank of Canada, which was nationalized by a Liberal Government in 1938, and 12,000 private shareholders bought out during a depression at a good profit after three years of owning the stock., all the interest paid on the Bank of Canada loan returns to the Government – less some minor overhead expenses – as dividends. That is not funny money, note well, but a basic capitalist institution.

Obviously this would have been the course for the government to take. There would have been no need to sell buildings that the government will never be in a position to buy back. And every improvement to the services of our large cities sends the value of well-located real estate in them still higher. That is why the Norman Conquerors of Britain, rarely parted with properties located at nodal points of the Roman roads that the Anglo-Saxons were unable to continue building. They rented those in nodal points like London or York on 100-year leases with adjustments of rents during their leases.

There is then many more and more significant questions to be asked than the one asked by NDP MP Peggy Nash: "It may look good on the books in the short term that there is a big sale price. The question is whether this is in the long-term interest of Canadians, because we are going to be on the hook for these arrangements." For example why has the government not brought its buildings up to scratch by making use of the *Bank of Canada Act* which is still on the books, though unused and never referred to? Why is it still on our law books? Because in 1982, when the Canadian constitution was being drafted, PM Brian Mulroney proposed putting "zero inflation" and the independence of the Bank of Canada from the Government of Canada in the Constitution and his own caucus on Finance Committee turned him down. He did not dare tamper with the *Bank of Canada Act*. And to this date, none of the parties with members in parliament have addressed the anomaly of the *Bank of Canada Act* being on our law books, but never made use of or referred to. That is hardly a setting in which democracy is likely to flourish.

W.K.

What if Government Books are Systematically Cooked?

If we are driving over unknown parts of the country and end up in the wrong places, the first thing we do is consult a road map. In more general terms we seek reliable information on how we got from where we did not want to be.

It would be logical to do something similar when we are shocked about the direction in which society is headed. One of the key branches of information depends on the way our government records what it is doing. That is known as accountancy. And one of the most basic bits of accountancy is the distinction between current spending that serve us only during the current year and will have to be repeated every year. This leaves a zero balance in assets at year end. Other expenditures are investments, that will continue serving us for several and even many years. These do not have to be renewed annually.

They do call for annual spending for maintenance, failing which they will deteriorate. But their basic cost must not be written off in a single year. Unless you make that distinction, the government will be reporting a deficit in its accounts that does not exist. If a private taxpayer followed this method, he would be sued by the government for having grossly understated his earnings and thus eluded due taxation on his earnings. For clearly if you write off your investments in a single year you are hiding the assets resulting from your investments and evading the taxes you owe the government on your total profits. Why then did it require the recommendations of at least two real royal commissions and the recommendations of several auditors general before our government in 2000 – five years after Washington took the step – introduced the distinction between its physical investments and bridges, roads, schools highways, battleships and the tissues it supplies in the washrooms of its buildings? And why are the governments investments in human capital – that economists had been decorated for recognizing as the most productive investments a government can make – why are these still treated as current spending?

This violates the basic law of double-entry bookkeeping that the Templars are supposed to have learned in Muslim lands and brought back to Europe in the 13th century. Since the debt incurred to make the investment of the government is "amortized" over many years until it is paid off, the asset value, similar must be "depreciated" and its asset value diminished on the books more or less over the length of time in which it remains useful.

Forgetting What the Templars Brought Home

Enter the "amortization" of the investment debt incurred but use a single year write-off – but fail to "depreciate" the investment assets of the government and you have violated the basic law of accountancy. Why then did our previous Prime Minister, Paul Martin, when still Finance Minister resist the ultimatum of the then Auditor General, who refused to give unconditional approval of the government's balance sheet and even described the government's "cash accountancy" as "cooking the books." The answer is a clear and damning one – our government was following instructions from a foreign unelected body, the Bank for International Settlements to which it – along with other governments – had surrendered its fiscal and economic policy-making. BIS was preparing the balance sheets of governments throughout the world so that it could campaign for higher interest rates, and still greater powers of speculation for the world's banks.

It mattered little that such policies had already brought about not only the Depression of the 1930s but a chain of speculative booms and busts. But there are yet other effects of using what is known as "cash accountancy" – i.e., recording the amount of money that has been spent in the course of the year, while making no distinction between what has been invested, rather than just spent. These will only gradually lose their market value. That gradual decline of the value of capital assets is known as "depreciation." And the gradual repayment of the debt incurred to acquire the capital asset is known as "amortization." The two do not necessarily coincide in their rates. But they do have the general effect of balancing one another. Leave one out and record the other, and you distort both the costs of the infrastructure or the burden that it may represent. If your fail to make the infrastructure spending – whether maintenance of existing infrastructure or new infrastructure that is needed – you will exaggerate the "fiscal prudence" of the government – a favourite political trick. The way to deal with that is to list any maintenance or replacement costs of necessary infrastructure that are not made in the government's books as a *capital deficit* that sooner or later will have to be made good with penalties both in human lives and monetary outlay.

That subject is gently grazed in the next-too-last paragraph of Bob Herbert (*The New York Times*, 05/04, "Our Crumbling Foundation"): "Through the establishment of a national trust fund for example of a federal capital budget: a national trust fund is too remote and 'long-term' and a 'federal capital budget' too difficult to elbow their way into the nation's consciousness." However, without a debit item to offset the false asset supposedly resulting from not having spent the necessary funds for essential infrastructure or its maintenance, you simply haven't applied double-entry accounting. What you lack, in that case, is accountancy in any earnest sense of the word. What you have had inserted in its place on very false pretences is misinformation. And that is no accident. From times immemorial bookkeeping and taxation have been abused as instruments to the advantage of one social group at a hidden cost to another.

However, it is in the class interests of the majority of humans including those of conscience who are members of the more privileged classes, to consider the survival needs of the human race – something that is threatening the ruin of our environment.

Our bookkeeping, that is our basic information about what spending that will be used up in the course of the year will have broken down. Or resorting to the motoring analogy: unable to distinguished between main highway and side road in our road map, we have become lost in a maze of badly distorted and hence harmful misinformation.

"Fifty-nine years ago this week – on April 3, 1948 – President Truman signed the legislation establishing the Marshall Plan, which contributed so much to the rebuilding of postwar Europe. Now, more than a half century later, the US can't even rebuild New Orleans.

"It doesn't seem able to rebuild much of anything, really. According to the American Society of Civil Engineers, the US infrastructure is in sad shape, and it would take more than a trillion-and-a-half dollars over a

five-year period to bring it back to a reasonably adequate condition....

"But as we learned with New Orleans, there are consequences to neglecting the infrastructure. Just a little over a year ago, a dam in Hawaii gave way, unleashing a wave 70 feet high and 200 yards wide. It swept away virtually everything in its path, including cars, houses and trees. Several people drowned.

"On the day after Christmas in Portland, Ore., a sinkhole opened up like something from a science fiction movie and swallowed a 25-ton sewer-repair truck. Authorities blamed the sinkhole on the collapse of aging underground pipes.

"Blackouts, school buildings in advanced states of disrepair, decrepit highway and railroad bridges – the American infrastructure is growing increasingly old and obsolete. In addition to being an invitation to tragedy, this is putting America at a disadvantage in the ever more competitive global economy.

"Felix Rohatyn, the investment banker who helped save New York from bankruptcy in the 1970s, has been prominent among those trying to sound the infrastructure alarm. Along with former Senator Warren Rodman, he has been criticizing the government's unwillingness to invest adequately in transportation systems, water projects, dams, schools, the electrical grid, and so on.

"He recently told a House committee that Congress should begin a major effort to rebuild the American infrastructure 'before it is too late.'

"'Since the beginning of the republic,' he said, 'transportation, infrastructure and education have played a central role in advancing the American economy, whether it was the canals in upstate New York, or the railways that linked our heartland to our industrial centers; whether it was the opening of education to average Americans by land grant colleges and until the GI bill, making education basic to American life, or whether it was the American highway system that ultimately connected all regions of the nation.

"'This did not happen by chance, but was the result of major investments financed by the federal and state governments over the last century and a half.... We need to make similar investments now.'

"Politics and ideology are the main reasons that government has turned away from public investment for several years. Zealots marching under the banner of small government have been remarkably effective in thwarting efforts to raise taxes or borrow sufficient sums for the kind of investment that has always been essential for a dynamic economy."

Productivity Depends on Infrastructure

"That this is counter-productive in a post-20th-century world should be as obvious as the sun rising in the morning. There is a reason why countries like China and India are racing like mad to develop their infrastructure and educational capacity.

"'A modern economy needs a modern platform, and that's the infrastructure,' Mr. Rohatyn said in an interview. 'It has been shown that the productivity of an economy is related to the quality of its infrastructure. For example, if you don't have enough schools to teach your kids, or your kids are taught in schools that have holes in the ceilings, that are dilapidated, they're not going to be as educated and as competitive in a world economy as they need be.'

"Mr. Rohatyn and Mr. Rudman are co-chairman of the Commission on Public Infrastructure at the Center for Strategic and International Studies. They believe that failing to move quickly to address the nation's infrastructure needs – through the establishment of a national trust fund, for example, or a federal capital budget – could lead to long-term disaster."

And then comes the most critical passage in Bob Herbert's most significant column: "But words like trust fund and long-term and infrastructure find it difficult to elbow their way into the nation's consciousness. We may have to wait for another New Orleans before beginning to take this seriously."

Indeed, all the New Orleanses in the world won't do the job, unless we recognize what the growing obstacle has been to the realization of what was well on the way to being incorporated into the national and international consciousness in the post-War II generation.

For the most part Mr. Rohatyn and Mr. Rudman, though certainly deserving applause and gratitude for their efforts, merely graze the main source of infrastructural neglect. If we may return to our metaphor of the opening paragraph of the present piece, we might say that they concentrate on the regrettable state of the roads that makes it difficult arriving at the green acres because of the neglect of the road. But there is neither emphasis on the possible motives that led to this deplorable neglect, but

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to the even more misleading information spread by the map. Information, however, was listed as one of the key infrastructures. And that at once suggests an even more disturbing element that we could even call "negative infrastructure" – that occupies a key position in leading up to this ruinous state of affairs.

For decades auditors general of governments throughout the world advocated the adoption of "accrual accountancy" that accrues the depreciation (the loss of value) of a capital assets over its useful life. This, balancing the "amortization" of the debt incurred for the acquisition of the said asset likewise "accrued" the repayment of the debt incurred to acquire the asset. Occasionally, governments to encourage the acquisition of equipment by industries they considered specially important in the national interest, so that the excess of depreciation over amortization would provide a degree of tax protection, but the two more-or-less similar factors were essential for double-entry bookkeeping.

Attempts were made to bring accrual accountancy onto the balance sheets of European governments. Sweden and Denmark had it for a while until globalization took over. Keynes proposed it in his youth for Britain, but being essentially a brilliant social-minded opportunist, he was not prepared to waste his talents knocking his head against a stone wall, and soon abandoned it.

It has in fact been brought into the government books of the United States in part as of the Department of Commerce figures on government "savings" starting in January 1996. The story is told elsewhere in this issue of *ER*, but we will retell it to make up for the universal silence on the matter.

The severe restrictions imposed on American banks brought in by President Roosevelt when 38% of American banks had shut their doors, led to a new severe regime to make the banks stick to banking under the *Banking Act* of 1933. They were restricted in the rates of interest they could charge or pay. The were prohibited from acquiring an interest in the other "financial pillars" – insurance, stock brokerage, and mortgage lending. In that way they would not be able gamble cash reserves these other financial corporations needed for their own affairs, after using them as money bases to which to apply the bank multiplier.

Under such controls the banks recovered and began plotting their comeback step by step. Pursuing strategies developed by the Bank of International Settlements (BIS) based in Basel and constituting a central bankers' club of a sort, the deregulation and globalization of the banking system are plotted and put into effect. By the early 1980s American banks had lost much of their capital, and to bail them out of their losses, BIS introduced two major measures. In 1988 it declared the debt of developed countries risk-free and consequently needing no down-payment for banks to apply. The Canadian banks accordingly quadrupled the federal debt from $20 billion to $80 billion. To make this possible deposits of the Federal government were withdrawn from the central bank and deposited with the private banks.

Since the government had been sole shareholder of the Bank of Canada since 1938, the interest it paid on its debt held by the Bank of Canada, came back to it substantially as dividends. What it now paid the private banks stayed with them. Then again, the statutory reserves that the banks had to redeposit with the Bank of Canada from the deposits they received from the public were terminated. On these statutory deposits the banks were paid no interest. For the loss of net revenue from extending their lending when the central bank felt that the economy was overheated could be achieved wholly or in part by raising or lowering the statutory reserves without the central bank relying wholly on raising or lowering the benchmark interest rates.

And that being done, and a huge amount of vastly leveraged near- (i.e., interest-bearing) money being released into the economy, the BIS prevailed on central banks throughout the world to raise interest rates until prices would retreat to what they chose to call Zero Inflation – i.e., lie absolutely flat. But in its haste to get the banks out of their hole, BIS and its retinue of central banks overlooked a tiny but important detail. When you raise interest rates so athletically, the market prices of pre-existing bonds with lower coupons fall as over a cliff. This bankrupted the Mexican banks who had actually issued bonds ("tesobonos" that included an option of the buyers to get repaid in pesos or US dollars). Mass flight of capital took place out of the country – made possible by the free currency movement guaranteed under the North American Free Trade Treaty. The peso lost some 40% of its value, With the flight of capital, unemployment rose. The country became vastly more dependent on the remittances of immigrants to the US, legal or illegal. Without the deregulation of the banks, there would be no wall on Mexico's northern frontier.

To prevent the Mexican banking collapse from pulling down the world banking system, a $51 billion standby fund was improvised by the US, the IMF and Canada. And it finally penetrated the minds of the US Department of Finance that the days of low high interest rates had come to a screeching close, because the banks needed the government debt to fill the holes left by their gambling losses. A way out was devised. Accrual accountancy – of all things – was smuggled into the books of the government, but under a pseudonym, like a proscribed criminal moving in stealth. Carried back to 1959, the recalculation of depreciation of government assets was reworked to come up with some $1.3 trillion. This appeared in the Department of Commerce figures under the title of "savings" which, of course, it wasn't, for rather than cash or short-term securities of the government, they consisted of building roads, bridges, equipment. But the myth that governments are incapable of investment – and that only banks that governments have been bailing out more frequently than once a decade – were to be trusted with investment.

Public Investment in Human Capital is Still Ignored

But as I have explained elsewhere in this issue, that still left intact the complete disregard pf human investment that Theodore Schultz of Chicago University had concluded was the most productive investment that a government can made. Schultz based his conclusion on the astounding rapidity with which Germany and Japan had recovered to a prominent exporting position from the physical destruction of World War II. Schultz's conclusion was that he and hundreds of other young economists that Washington had dispatched to the two countries had been so wrong, for having concentrated on the physical destruction, while what mattered mostly was that the highly educated and disciplined work force had come out of the war largely intact.

Canada has soldiered on profiting by the low interest rates with which the bond rating agencies rewarded the improved balance sheet of the US. But Mr. Paul Martin, then Finance Minister, resisted the refusal of the Auditor General to approve two successive balance sheets of the government unless accrual accountancy were brought in. That finally happened for the federal government's physical investments in 2000.

W.K.

Frightening Tales Streaming Out of our Schools and Universities

Whether it is the Virginia Tech Shootings where a troubled young man killed 33 of his fellow-students and staff members for no reason at all except his own untreated mental problems; or whether it is the pension funds moving in on the profits to be had by taking over the financing of student loans to finance university fees that have already become beyond the reach for most students.

To cope with what this does to our storyline we the tellers must reverse the sequence of the tale antedating the solution to the fuller exposition of the problem. We will begin by reviewing society's memory of the great economist who straightened out our thinking on such matters, and made it possible for society coming out of ten years of brutal depression and six of murderous war to assimilate millions of mostly penniless immigrants, educate for free the returning young veterans. Today, however, all this, and much else that had been possible has slipped out of our reach.

One of the forgotten economists having to do with the subject of the present piece – the ever more unattainable costs of a university education, taught at the University of Chicago, notable for its conservative economics faculty. He was called Theodore Schultz. Few economists will remember his name let alone his teachings. At the end of World War II he had been one of the hundreds of young economists that Washington sent to Germany and Japan to foretell how long it would be before these two defeated lands could regain their positions as formidable competitors on the world markets. Twenty years later, Schultz won the Bank of Sweden Prize for economists for his writings explaining why his own conclusions and those of his hundreds of colleagues had been so wide of the subsequent reality. Both Germany and Japan were up and competing the pants off the victors of the war in a fraction of the time Schultz and all those hundreds of his young colleagues had foreseen. He reviewed their reasoning, and reached a momentous conclusion: they had concentrated on the physical destruction and overlooked the importance of the unusually highly educated and disciplined work forces of these two major defeated lands had come through the war essentially intact. Ergo: human investment – education and hence health and social services that help preserve that investment – are the most productive investment a nation can make.

Even before Schultz formulated his revolutionary conclusion, some of the political leaders of the day had acted as though they had intuited such a conclusion. That was because governments had made commitments to the men in fighting forces that they were exposing themselves to unlimited sacrifices for a postwar that would be different from the unspeakable 1930s. New schools, and post secondary institutions sprang up like mushrooms after a rain. Fees were low – and for veterans non-existent. New technologies – like TV that had been developed in the 1920s but was unthinkable during the depression, when fewer and fewer people could afford a radio or a sandwich. And 38% of the banks in the US had shut their doors and were not lending, and most people were too frightened to borrow or risk starting a business. And then, especially with the war, these problems had been left behind.

Banks Put in Doghouse

Largely because of the *Banking Act* brought in by President Franklin Delano Roosevelt just months after his inauguration. Even before that he had declared a bank moratorium and renewed it when it expired, because the banks were in no position to face the risks of banking. Let alone the speculative binges with bank capital and deposits that had brought on the 1929 crash and the Depression. Roosevelt's *Banking Act* brought the banks back to banking. It prohibited them from using the defining power of banking – lending out a multiple of the legal tender they actually had in their possession – to acquire the "other financial pillars" – stock brokerages, insurance and mortgage companies. For good enough reason these "other pillars" kept their pools of liquidity – cash and short-term interest-bearing securities – to meet the needs of their own businesses. Allow the banks access to these and inevitably they would end up using them as money base for their banking multiplier. That was diagnosed as a root cause of the Great Depression that led to World War II. Ceilings were imposed on the rates of interest banks could pay or charge.

Unlike our political leaders today, Roosevelt and his cabinet had ears for every suggestion that might help the economy out of the paralysis that had overtaken it.

A Time When Desperate Governments Took to Listening

With little understanding of economic theory, Roosevelt nonetheless felt that it was necessary for the government through the Federal Reserve to undertake necessary capital projects to start the economy moving once more. This they did to a very limited extent before the war, and on a far greater scale to finance the war, and on a yet still greater one to finance the reconstruction at home and abroad. In the United States, the Federal Reserve to this day is owned by private banks. However, because of what is known as government *seigniorage* – the bestowing on the banks the modern equivalent of the ancestral monarch's monopoly in the coining of precious metals. That is why most of the profits of the Federal Reserve System is remitted to the government that has surrendered to the Fed this inherited privilege of the central government.

In Canada the case is far clearer. The Bank of Canada had been founded as a privately owned institution in 1935 under a Conservative government. But in 1938, the Liberal government of William Lyon Mackenzie King had bought out the 12,000 private shareholders at a good profit, and the net profits of the Bank of Canada comes to it as the good old capitalist institution of the dividends – not the slightest suggestion of "funny money" there. And the fact that the central bank had been nationalized made it possible for Canada to exceed both the American Government and Westminster in the extent to which it made use of its central bank to finance its part in WWII and in the postwar period.[1] That is why both Canada and the United States were able to expand their educational system at all levels not only to catch up with the neglect during sixteen years of depression and war, to assimilate a vast, largely penniless immigration, but to introduce new technologies that had need of far more educated consumers, let alone producers. This implies an ever greater public investment in human capital.

And there is an important detail that is rarely if ever mentioned. While making these capital investments both in physical and human capital, governments did their bookkeeping in a primitive sort of non-accountancy that would never be tolerated in the private sector. This is referred to as "cash accountancy." By this the capital asset the government acquired was not depreciated over its useful life but was written off in a single year when the project was completed and the financing arranged. Nonetheless, though "cash accountancy" wildly overstated the net debt of the government, using the central bank during the first three decades of the peace most of the debt incurred during the war was retired.

In the case of Canada, the ratio of the public debt to the GNP in 1946 had amounted to about 160%. By the mid-1970s this had fallen to less than 25%.

And this was a full decade before Theodore Schultz drew his epoch-making conclusion from his surprisingly rapid recovery of Japan and Germany from the destruction of WWII.

Had the work of Schultz, briefly celebrated though it was, not been buried – excluded from economics courses in our universities and no longer mentioned in the press – it is improbable that the Sallie Mae scandal could have occurred.

At this point we shall bring in the reporting of our media to reveal the greatest beneficiaries of the new view of the educational process. As in much else in our economy, the highly leverage hedge funds are coming to define the priorities of our educational system as well.

Let us listen to *The New York Times* (21/04, "Sallie Mae Offers a Lesson on Cashing In" by Joe Nocera): "Aren't you just fuming about that Sallie Mae deal? The company, formally known as the SLM Corporation, which has been the subject of recent exposés and investigations, announced this week that it had agreed to be taken private in a deal worth $25 billion. The stock, which has been in a slow decline over the past year, leapt.

"But I'm here to tell you that the deal stinks, though not in the usual 'management and private equity are stealing your company' kind of way. You're free to disagree, of course, though if you do, you're probably not struggling to put your children through college.

"Sallie Mae is the nation's largest student lender; indeed, it dominates the business. It has the largest share of government-guaranteed loans, originating $16 billion of such loans last year alone. It also generated $7.4 billion in 'private' loans: that is, loans that aren't guaranteed, but which students need because their tuition, room and board so far exceeds the pathetic $23,000 of guarantees over the course of an undergraduate degree.

"The most popular government-guaranteed loans come with rate caps (currently 6.8%) but they also have certain undeniable advantages for Sallie Mae and its competitors. They are subsidized by the Department of Education. The government makes the lenders nearly *whole*, even if the student defaults. And the companies are guaranteed *by law* a decent rate of return.

"In other words the lender takes no risk, even if the student defaults. The private loans are even more lucrative because companies can charge whatever rates they want – not to mention all sorts of fees. Sallie Mae originated 25% of the student loans made last year."

Sallie Mae Buys Up and Piggy Backs Government Loans

"But wait. There's more. Sallie Mae buys loans from other education lenders and then securitizes them. It has a loan consolidation business, so students can wrap all their education into one big fat Sallie Mae loan. It even has its own collection agency so it can hound delinquent broke graduates into repaying. (Government-guaranteed college loans, by the way, aren't easily discharged if the borrower files for bankruptcy.) Sallie's market power – and its close ties to university financial aid administrators, as we've been learning from Jonathan D. Slater, a reporter of *The New York Times* and others – have made it immensely profitable. In 2006, the company made over $1 billion.

"Thus you can't blame the private equity guys for drooling over Sallie Mae. They look at the arena in which it plays, and they see never-ending tuition increases. The need for a college education will only increase in importance. Most cash-short students and middle-class parents will continue to borrow lots of money to pay the $100,000 to $150,000 required to attend a good college. Although the Democrats want to cut the subsidies for government-backed loans, and lower the interest-rate caps, the more lucrative private market is going to continue to explode. No wonder the private equity firms of J.C. Flowers & Company and Friedman Fleischer & Lowe were willing to offer a 10% premium over Sallie's stock price – and load on $16 billion in new debt. This thing is a gold mine."

At this point it is important to make a point that is lost in the eruption of justified indignation that has greeted the Flowers privatization. If the memory of Theodore Schultz and his conclusion that human capital is the most important investment a nation through its government can make were not suppressed, it would have greatly increased the likelihood that the government would have treated the Fed system for financing higher education as an investment. It would have refused to allow stock market vultures to exploit student borrowers. Today some university administrations have come to regard their endowments as just another hedge fund.

If Schultz had not Been Forgotten

But back to *The New York Times* piece: "But there's another, less market-oriented way to look at this. The entire educational-lending racket is built around the business of piling thousands of dollars worth of debt onto a class of Americans who will probably have to struggle to pay it back. 'We ask people who are trying to make something of themselves to mortgage their future, and Sallie Mae profits from that,' said Elizabeth Warren, a professor at Harvard Law School.

"And when those former students have to start paying back the loans, and they don't have a good paying record and start to fall behind, the industry takes full advantage. Meanwhile many of the practices now under investigation by the New York attorney general, Andrew M. Cuomo, are intended primarily to keep out competition that might bring down the cost of these loans. Last week, Sallie Mae paid $2 million to settle an investigation that Mr. Cuomo's office was undertaking. In other words, Sallie Mae and its competitors are maximizing profits on the backs of students.

"It wasn't always like this. Sallie Mae was started in 1972 and for most of its existence it was a 'government-sponsored entity' like Fannie Mae or Freddie Mac. Its primary role was to buy up and securitize government-backed student loans originated by banks and others, so that in turn the lenders would have the cash to make other loans. The government subsidized such loans to give lenders the incentive to make them, and the margins were thin. The private loan business largely didn't exist.

"During the Clinton administration, the government created a new direct loan program, thus potentially cutting out the

industry, and leaving Sallie Mae with the prospect of being irrelevant.

"At the time Sallie Mae was prevented from originating its own loans.

"In 1992, Albert L. Lord, became CEO of Sallie Mae (he remains the company's chairman). Despite presiding over a government-sponsored entity, Mr. Lord was an unapologetic capitalist, who decided that Sallie Mae's best bet was to untether itself from the feds and go directly into the loan business.

"Under his leadership, Sallie shed its status as a government-sponsored entity and began the process of dominating the industry. It built those controversial ties to financial aid officials. It helped push back the direct loan business, which many people believes offers taxpayers a much better deal. It got into the private loan business. It became the 800-pound gorilla. From 1999 to 2004, Mr. Lord accumulated $235 million, most of it from stock options. He got so rich making student loans that he even led one of the groups trying to buy the Washington Nationals baseball team."

Cooperation of Educational Aid Officials and Lenders

"It wasn't until a new entrant into the field, MyRichUncle, began running a series of advertisements asking pointed questions about the cozy relationships between financial aid officials and the officials and executives at the big educational lenders, that the world took notice. The small company's two founders, Raza Khan and Vishal Garg, both 29, had the radical idea that if they offered lower interest rates and a better deal, students and parents would flock to them. Instead they discovered that most people did whatever the university federal aid officer suggested, and that they couldn't get on the list of 'preferred lenders.'

"Shut out by what they saw as a cartel, they decided to fight back with a public campaign. That campaign helped set in motion the current investigation by Mr. Cuomo – and earned MyRichUncle founders the eternal enmity of Sallie Mae and the rest of the industry.

"According to a Sallie Mae senior vice-president Barry Goulding and Tom Joyce, its vice president for corporate communication, 'the vast majority of schools go through a competitive bidding process and get the best deals for students,' Mr. Joyce said.

"According to them – and they are right about this – a big part of the problem is that Congress hasn't raised the limit on government – guaranteed since the early 1990s, and that fact rather than the lenders' greed has driven the explosive rise in private loans.

"But even so, the current for profit student lending industry is still more about shareholders and profits than about the genuine needs of students, who very often don't have enough money in the first 2, 3, or even 10 years out of college to pay the high interest rates and onerous fees that make the industry so profitable.

"There are some things in life that really ought to be about more than making money. Surely student loans should be on that list. Sallie Mae was once an institution where profits took a back seat to performing a public good. That, alas, is no longer the case.

"Lest you should doubt me, listen to Mr. Lord himself. On Thursday, *The Washington Post* published an interview in which he bluntly declared that his decision to take the company private stemmed from his frustration with 'the politicians' whose decisions were hurting Sallie's share price.

"I didn't see our share price rebounding any time soon and I said 'This is silly.' Mr. Lord added that when the buyout is complete and he leaves the company, he'll walk away with a $135 million payout.

"Are you mad yet?"

Being mad is not enough. We must reconstruct the process of gelding economic theory and hence information with such villainous end-results.

William Krehm

1. Britain nationalized the Bank of England only under the Labour government after the War, and the United State has not done so to this day.

An Economy Unstrung?

The Globalization and Deregulation mantra imposed on the world some three decades ago showed no concern for the material and cultural barriers that developed over the ages for valid social purposes. That is turning up not only the ever more frequent and bloodier results when powerful economies encroach on the defences of societies that may wish to choose what they borrow and at what cost from alien economies. It is hardly surprising then that increasingly not only in the Vietnam script which ended in humiliating disaster should have taught Washington little or nothing, either in its original production, or its enactment on a larger scale in Iraq and Afghanistan. And now it appears even in a domestic version that is increasingly leaving its authors and promoters unhelpfully puzzled.

A sample of this appears in two recent articles in two leading American publications. The one in *The New York Times* (22/04, "Mortgages' Mystery,' The Losses" by Gretchen Morgenson): "Have you noticed how quickly financial market crises come and go nowadays? Refco, the venerable commodities firm, disintegrated in a week in 2005 and last year's demise of Amaranth, a $6 billion hedge fund, took about the same amount of time. It is a measure of how deep and wide the money pools are today that the billions lost by these institutions amounted to no more than a blip on the screen.

"The mortgage mess, however, has a different look and feel. As much as developers, lenders and home sellers want it to be over, it is likely to drag on.

"There are several reasons for this. Working out troubled loans one by one takes time. So does selling tracts of empty homes. But there is also this: because of the way mortgages are packed into pools and sold to investors, it is still not clear who owns the faltering loans and how much money has been lost." Separating the good from the bad members of a loan package, is in away like the case of separating the twins born joined at their heads that is receiving so much attention in our press at the moment.

Mortgage Mess Drags On

The "syndicating" of mortgages into various "risk grades" so that the investors could go for greater rewards by indulging their taste for higher risk, was hailed a great step forward in the technology of investment. Attention was focused on the higher winnings if the Lord above smiled on the blessed and valiant, rather than upon possible losers and, indeed, their less risk-seeking neighboring investor who may have bought an adjoining less risky swath of the risk-melon, but nonetheless finds his investment entangled with the mess of his more swashbuckling neighboring investor.

"This episode seems to be unfolding in slow motion.

"Certainly the bad news keeps coming. Last week we learned that foreclosure rates

soared 47% in March over the same period in 2006.

"Realty Trac, a keeper of a database of properties in foreclosure or about to be, reported that California had 31,434 foreclosures in March, nearly triple the figure from the same period last year. Foreclosures in Nevada and Colorado also surged.

"Fears are also rising among builders as well. The National Home Association of Home Builders/Wells Fargo Home Price Index, a measure of builder confidence, fell to 33 in April. Last year at this time, the index stood at 51.

"'A crisis in standards in connection with sub-prime mortgages has shaken the confidence of both consumers and builders,' said David F. Senders, the chief economist at the home builders association.

"A report from assets-backed-securities analysts at Lehman Brothers last week estimated that some $19 billion in losses are sitting in loan pools assembled in 2005, 2006 and early 2007. Many of these are in collateralized debt obligations, securities that invested aggressively in mortgages in recent years and that pension funds, insurance companies and hedge funds all hold.

"Sounds like a lot of money? It accounts for about 5.5% of all mortgages issued and outstanding in the period.

"These figures are estimates, not actual losses, because accounting rules allow pension funds and insurance companies that hold these securities to mark their stakes at the prices they paid for them, not at their market levels. The losses are there, but they remain unrecorded.

"Only when the investors sell their holdings do they have to book the loss they incur. That's no fun so investors are likely to hang on to their holdings as long as they can. If they need liquidity, they could be forced to sell. Another thing that could force sales: a down-grade by Moody's, Standard & Poor or Fitch Ratings, the credit rating agencies. Many pension funds and insurance companies cannot hold securities rated below investment grade – 'junk' in industry parlance.

"Notwithstanding all the news about defaults, delinquencies and foreclosures, the rating agencies have not downgraded many mortgage loans because, they say, they

Monetary Reform Mass Education

I would like to jump into your discussion on the question of mass education.

My head is aching from 10 years of banging it on a brick wall. It's true that occasionally I get a letter in the Whig. I don't know of any getting into the *Star* or *Globe* or *Post*.

Letters to ministers of finance are inevitably acknowledged with the statement that using the BoC to finance public debt will cause inflation.

After much effort, Kingston Council adopted a motion in April/01 asking the government to allow municipalities to borrow from the Bank of Canada. This motion, along with one from BC, was sent to the Federation of Canadian Municipalities which adopted a similar one in September/01. The FCM wrote to the government, but the only reply they got was an acknowledgement that their letter had been received. Their staff did some "research" and "learned" that borrowing from the Bank of Canada could not be done. I challenged the so-called research, but was ignored.

After years of writing to the NDP, a policy on the Bank of Canada was included in the 2004 election platform, *but* it was removed from the 2005 election platform and replaced by one recommending the establishment of a brand new bureaucracy which would centralize all government borrowing in one place and thereby benefit from lower interest rates resulting from large scale borrowing. It completely ignored the BoC which already existed and could lend money cheaper than a central borrowing agency could borrow it.

We have held community meetings, getting about 50 in attendance, but they never led to more expressions of interest.

I have explained to social action groups that there would be more chance of getting the funds or programs needed if they would support COMER's attempts to get the government to borrow from the BoC, but the response was merely a polite showing of interest–no action, except for the Ontario Health Coalition. After I spoke to the meeting of the coalition in the fall of '06, Natalie Mehra said she would bring it up with her board. I offered to arrange for a COMER member to attend the meeting of the Board when they were to discuss the question, but she said it would be better if she put it to them with a recommendation that the matter be referred to committee; then we might be able to attend the committee meeting. Nothing more has come of it.

The CBC has never even acknowledged letters re the BoC except the *Fifth Estate* which wrote to say it would be considered as a subject for investigation. I sent letters to my many COMER contacts suggesting they write letters of support to the *Fifth*. Within 48 hours I received a letter from the *Fifth* saying their email was jammed with letters supporting investigation of the BoC, and would I please ask my supporters to stop sending letters. In any case, they added that the *Fifth* will decide, implying that they don't like to be pressured. I did as requested; the letters stopped, but nothing further was heard.

So I have come to the conclusion that mass education has to be undertaken, but how to do this when the mass media are not willing to carry the message. I wondered if the internet could be used, but my competence in that area is very limited. I mentioned this to Peter Zuuring one day and he said his son, Frank, could help. The two, Peter and Frank, came to my house to see what kinds of information I had. By chance, I had recently received a DVD produced by Paul Grignon in BC on "Money as Debt" – a very well done animated history of money creation.

We watched the short version of the film (17 minutes) and had a long discussion. Frank will consider how the information might be presented on the internet (on sites like "My Space," virtual life or maybe the youtube sites which have a vast audience) and has agreed to attend our meeting on the 15th to explain his ideas.

I will run the long version of the film, 47 minutes, early in the meeting so everyone can see it. It is really excellent. It connects money and banking with the environment, which Keith recommends we do. It is the type of thing that could be shown to small or large groups, followed by discussion. However, using the film in this way does not reach the mass audience we need to reach to build enough political pressure to bring about change. Along with showing the film or extracts from it plus other information on the internet, we could show which politicians support monetary reform and encourage voters to vote for them.

Richard Priestman

do not expect their original assumptions regarding the loans' performance to change substantially.

"While investors have not had to face harsh market realities, homeowners looking to refinance their loans will not be as fortunate as lenders tighten their underwriting standards and home prices soften, according to Lehman. Lehman says it expects 20 to 30% of borrowers who took out loans last year will be unable to refinance their mortgages when the terms of their mortgages reset. It expects as many as 15% of borrowers who struck deals in 2000 to be shut out of the mortgage market when they try to refinance.

"Last week, investors were heartened by Freddie Mae's announcement that this summer it would begin offering $20 billion in loans to borrowers trying to refinance their mortgages. Fannie Mae, another big mortgage-lender, has also agreed to put money into a refinancing pot.

But that money is not intended for the refinancing of mortgages that should never be written.

Though the Canadian mortgage field has experienced none of the speculative involvement in sub-prime mortgages that prevails in the US, our banks – particularly the Bank of Montreal which controls over 9% of the banking in the Chicago area – are deeply involved in both the US and Latin America. And of course, Canada, is particularly exposed to the course of US interest rates. It feels the competitive effects of a lower US dollar if interest rates sink, or the financial burden of costlier financing if they rise.

W.K.

The Uncharted Adventure Shifting from Oil to Coal to Nuclear Energy

The developments in the energy field are of an increasingly tangled complexity. *The Wall Street Journal* in recent weeks has devoted two articles to amazing developments in the Texas energy industry. The first of these articles (26/02, "Bidders Try to Pre-empt Gridlock in TXU Deal" by Rebecca Smith, Dennis K. Berman and Henny Sender), reports that "a total of six firms – led by Kohlberg, Kravis, Roberts & Co., Texas Pacific Group and Goldman Sachs Group – was completing a deal to buy utility powerhouse TXU Corp. for $32 billion plus more than $12 billion in TXU debt." And even before the ink had dried on the agreement, the *WSJ* reports "the creative twist, by which the firms have moved quickly to pre-empt opposition from powerful environmental groups, while seeking support from various regulators and politicians. Already the buyers have promised to cancel plans to build most of the 11 coal-fired plants under development. And they have sought to placate consumers with rate reductions."

The previous owner remains a partner in the present takeover. Formerly, it had had no time of the day for diplomacy with officialdom on high or with their consumers below.

Today, however, there is a clear effort at outreach to all parties involved.

Incredibly the new owners are seeking government support to protect consumers from further price jumps, appeasing environmentalists, and employing its tenderest tones of voice to live down the harsh impression that past policies left with customers.

Let us begin by noting some of the drastic changes in the problems confronting the energy industry, that have inspired so much novelty in corporational behaviour In the earlier issue referred to, *WSJ* wrote: "Equity firms once shunned utilities as capital intensive, regulated and lower-return businesses. But now, in a world of cheap debt, their steady and predictable cash flows have made them targets" [for takeovers].

To this we need only add a word on what had brought down interest rates and kept them relatively low since 1996.

Deregulation, begun earnestly in the 1970s in a well-organized campaign that spanned the oceans, allowed the US banks to do what the *Banking Act* of 1933 had forbidden. It had explicitly barred banks from acquiring interests in the other "financial pillars" – stock markets, insurance and real estate mortgage firms. The reason: once the banks obtained access to the liquidity pools that such firms kept for their own businesses, they would use them as money base for bank credit creation in areas unfamiliar to them, and inevitably they would lose their capital as though on a pre-timed schedule.

A Double Rescue from the S&L Adventure

And in fact just that happened as a result of the US banks acquiring the Savings and Loans which were essentially mortgage providers. To bail the banks out from their massive capital losses in 1988 the Bank for International Settlements developed two rescue policies designed to bring the banks back to the glory days of speculative banking that had led to the October 1929 crash and the decade of Depression that pushed the World into WWII. These two main policies towards that end were: (1) In 1988 the BIS brought in the "Risk-Based Bank Capital Requirements, that declared the debt of developed countries risk-free needing no down payment for banks to acquire. What resulted was a shift of central government debt throughout the world from central banks to commercial banks. (2) In the early 1990s (1991-1993 in Canada) the statutory reserves – the percentage of the deposits that private banks took in from the public that had had to be deposited on an interest-free basis with the banks were abolished in Canada, New Zealand and a few other countries, and reduced to inconsequence in others. Those reserves could be increased to diminish the banks' ability to make loans or lowered to make it possible for them to create more credit. On these reserves the central banks paid no interest, for such interest would diminish the Federal Reserve's leverage in influencing the scale of the banks' credit creation.

However, in their haste for bailing out the banks BIS who originated and managed the world-wide bank bailout, overlooked a crucial detail. For the urgency of the bank rescue was great and pressing. The banks had already closed their doors in Mexico in a wave that threatened to bring down the world monetary system. Hence what should have been evident to any schoolboy eluded the attention of the BIS: when you allow the banks to load up with government debt without down payment to replace their lost capital, and then you proceed to raise interest rates into the heavens to flatten out the price index, the market value of preexistent bond hoards such as those granted the banks, will drop like a stone and the banks will be in trouble once again.

This finally brought forcefully to the attention of the US Treasury that the days of high interest rates were over – since the

banks could not spare the interest of those bond hoards. To handle the problem. the Clinton Government brought in double entry-bookkeeping for the first time in handling the physical capital investments it made. For up to then when it built a bridge, a battleship, a school, a road, or whatever, it would write off the total cost when the project was completed and the financing arranged, rather than depreciating it over its useful life of the asset created. This resulted in a reported budgetary deficit, where no such deficit necessarily existed.

The asset value of the physical infrastructures resulting from such public investment would certainly have provided the collateral for the government raising the necessary financing if that were a problem. If the financing were done with the central bank – as it had happened on an increasing scale to cope with the depression, finance World War II, and during the first two or three decades of the peace in catching up with the neglect of 16 years of depression and then war, and to assimilate a huge, mostly penniless migration from Europe to standards required by the new technologies that had been held up by the depression and war. Moreover, when such investment in infrastructure were financed through the central bank of a country, virtually all interest paid on the loan would come back to the government as dividends. The central bank had been nationalized as in Canada in 1938 or the United Kingdom after the war.

Even in the US where the Federal Reserve System is still privately owned by commercial banks, almost the same amount of the Fed's profits as those of the Bank of Canada find their way back to the government as dividends but as a continuation of the *seigniorage* that the ancestral monarch enjoyed for having surrendered his monopoly in coining precious metals.

But that was kept from the public as an essential part of the deregulation and globalization campaign that had taken over with the Bank for International Settlements as the semi-underground bunker from where the come-back of the banks was directed. That is why when capital budgeting was brought into the US government books, in the Department of Commerce statistics beginning with January 1996 and carried backward to 1959, it brought to light some $1.3 trillion of assets. These, however, appeared not under the heading of "investments" but as "savings" – a term that economists reserve for assets in cash or near-cash form. Moving as they do in government circles, a wink and a nudge to the bond rating agencies who graded the quality of government credit, was sufficient to clue them into the real nature in the tremendous change in the government statistics. For the purpose, it was called "savings," which it most certainly was not, since the word as used by economists refers to assets in the form of near cash or readily transformable into cash, and these physical investments of government had been converted into bricks, steel and mortar, years and decades ago.

Call it what you might, this brought an end to the running of the economy in the exclusive interest of the banks and moneylenders of all categories. The old system treating the ever more expensive infrastructures needed by a modern society as current expenditures had been useful for creating a fictitious budgetary deficit, that justified in the eyes of the central banks to push interest rates into the heavens "to lick inflation." But it should have been clear that requires not only the ever more costly infrastructures that make an increasingly high-tech, urbanized society possible cannot be confined within a flat price structure.

And even the attempt to keep the price level flat with high interest rates was evidence that the financial sector had taken over the state apparatus. For it is the government bureaucracy rather than the elected members of parliament that decide such matters. There is neither crack nor mouse hole in our grand political structures that has not come to be taken over by the missionaries of our unsustainable culture of growth of the financial sector as an indication of the prosperity of society and the economy as a whole.

It should be noted that what has still not been brought into the accountancy of the US government or of any other government to this date is our government's growing investment in human capital. And yet on the basis of thee rapid recovery of Japan and Germany from their vast physical destruction in World War II, Theodore Schultz and other economists drew the conclusion that investment in human capital – education, health, and social services is the most productive investment that can be made. If that were taken into consideration, in the governments accountancy it is likely that the budgets both of the US and Canada in surplus and resources would be available without the central government having to go into debt and deficit to private banks.

What interests us here is the background of real causes – never mentioned to be sure – in the media or our legislatures, or in our universities, why interest rates have come down enough to change the strategy of the financial sector in power utilities. For they had been considered too unrewarding in their likely return to seriously bestir the great accumulators. But the consequences of the bringing in of capital budgeting and the enforced drop of interest rates to a somewhat tolerable level, have contributed to create a new pattern for the accumulation of wealth. As a result the deregulation of our great corporations is to the fore again and energy prices have taken a wild leap, for when the financial sector takes over, it is never for small, niggling profits. Their interest is not in the profits earned but in the capitalization of the growth rates of such rates of gain and the increase of the increased earning growth, all of which is incorporated in today's stock prices.

Dropping Interest Rates Make Utilities Interesting to Banks

But since 1996 in the US and since 2000 in Canada each investment expenditure brought into the ledger were appropriately balanced by the remaining or "depreciated" worth of that capital asset. Likewise if damage to the environment were not properly remedied, that, too would have to be entered in the government books – not as fiscal prudence, but as a *capital debt.*

Obviously this has an immense bearing on the wave of takeovers of fuel corporations, especially since it is nuclear-fired units that are up front in the plans of such take-over corporations. That requires an immense amount of physical investment, and with the rates for financing so much investment are down as explained above, there is a new host of massive investment that might be financed at lower rates, and no lack of uncertainty. New hands have accordingly been dealt out that is not without fascination for veteran mega gamblers, with all the resources of endless leverage, political wiles, and uncharted territory thrown open to be claimed by the most wily and best connected. In the words of the *WSJ* (26/02): "Private-equity firms once shunned utilities as capital-intensive, regulated and low-return businesses. But now, in a world of cheap debt, their steady and predictable cash flows have made them desirable targets.

"Twice before, two of the private-equity investors in the deal – KKR and Texas Pacific – have tried to buy utilities and come up short after running into a buzz saw of criticism from state officials and consumers.

"On Saturday, two big environmental organizations that had fought TXU's plans to build new coal-fired operations in Texas agreed to support the deal on the assurance that the buyers would cancel most of the plants.

"There is an element of stagecraft at work, too. TXU already had plans to cut six of those plants, said someone familiar with the company's intentions. The plants remaining on the drawing board are responsible for the lion's share of the profits of the entire 11-plant project, said another person close to the company.

"In 2003, Texas Pacific announced its intention to buy Enron Corp's Oregon utility, Portland General Electric. The deal attracted widespread opposition because Texas Pacific was seen as a short-term carpetbagger that would raise prices and gouge consumers. Among the firms Texas Pacific had acquired were Burger King, Continental Airlines and retailer J. Crew. Texas Pacific told investors in 2005 that its returns, before taxes, have averaged 55% a year. The Oregon utilities commission eventually nixed the Portland General deal on the recommendation of its staff.

"This time around, it was clear that the buyers needed a more strategic approach. At the heart of the potential owners' new campaign for support lies Texas Pacific representative William Reilly, a former administrator of the Environmental Protection Agency under President George H.W. Bush. Mr. Reilly became the public face for the buyout group largely because of his reputation among environmentalists. David Bonderman, co-founder of Texas Pacific Group has a similar reputation. He is touting his board membership of World Wildlife Fund as evidence that the group will act responsibly.

"In taking these steps, the investors are hoping to signal that they are not carpetbaggers, but rather long-term investors. That would be in contrast to past investments in utility assets such as Texas Genco, which Texas Pacific and KKR held onto very briefly before selling again."

It might be summed up as having matured to a degree of statesmanship where they feel the need for a Ministry of Foreign Affairs. However, the state of the world's affairs with no lack of diplomats around suggests that the entire solution to our energy problem may not lie there.

"The TXU deal amounting to some $32 billion, excluding debt assumed, is the biggest leveraged takeover to date. Exceeding Kohlberg, Kravis, Roberts & Co., $25 billion RJR Nabisco deal of October 25, 1988, which up to now held that distinction. The deal marks a quantum leap in the political sophistication of the buyout world. Buyout firms have generally received a chilly reception from utility regulators because they have been seen as temporary, profit-driven caretakers not answerable to public shareholders or sensitive to consumers. If the prospective TXU buyers can overcome that perception, they could potentially open the door for more private-equity investors. Regulators at all levels of government could trip the deal. It may also be subject to complaints from consumers who regard reasonably priced electricity a basic right."

Financiers Acquire Diplomatic Finesse

However, the tentativeness of the diplomacy that is the new trade mark of the take-over forces has many trials ahead of it. The second *WSJ* article (4/10) "TXU Sheds Coal Plan, Charts Nuclear Path" by Rebecca Smith) lays some of these out for us: "TXU Corporation has scrapped plans to build a large fleet of coal-fired power plants in Texas, but hasn't altogether abandoned its attention-grabbing expansion efforts. Instead it is hoping to build the biggest nuclear power plants in the US."

The shift to nuclear power is in the air that so many, in their different ways, profess to wish to purify. Little wonder then that there has been a growing boomlet in uranium stocks. "Three organizations other than TXU – NRG Energy Exelon Corp. and Amarillo Power – have said that they, too, may build nuclear plants in Texas. If all the plans materialize, Texas could have more reactors than any other state in a decade, built in a deregulated market where missteps would be borne by shareholders or the federal government, not residents and consumers. Before deregulation, ratepayers would have been on the hook for any blunders by the power companies and might have had to pay higher electric bills as a result."

Thus Texas could provide a proving ground for the expected nuclear renaissance because developers will proceed only if the economics appear bullet-proof. That is because utilities in Texas no longer have monopoly territories. If customers don't like one supplier's price, they can pick another." A surprise aspect of deregulation.

"Nuclear has gained power this year because it doesn't rely on fuels that emit global warming gases, like coal, or have volatile pricing. But cost overruns and accidents in decades past put development on the back-burner until recently. Nuclear energy provides roughly 19% of the nation's power; coal about half.

"At 1,700 megawatts apiece, the reactors selected by TXU designed and manufactured by Mitsubishi Heavy Industries of Japan would be half again as big in terms of capacity as the Westinghouse at TXU's existing Comanche Park nuclear plant, 80 miles southwest of Dallas. Company officials hope economies of scale will render the massive reactors capable of making electricity more cheaply than any others.

"Mitsubishi executives said they believe their plants can be built in the US for $1,500 per kilowatt of capacity, about 40% less than some industry estimates, giving customers a shorter period of time before their investment is in the black. Ultimately, TXU wants two to five new reactors. Of course, that is subject to change. TXU's directors accepted a $32 billion buyout offer in February from a private equity group led by Kohlberg Kravos Roberts & Co. and TPG, formerly Texas Pacific Group. If it is taken private, the new owners might alter TXU's investment plan. As part of that agreement, TXU agreed to cut bank on its planned construction of coal-fired plants, unpopular with local residents and environmentalists.

"NRG, Princeton, NJ, wants to add two 1,350 megawatt reactors to its South Texas Project, which has currently two units at an estimated cost of $3.5 billion apiece. Exelon, Chicago, is hunting for a virgin site abode to meet tough criteria for safety, water and transmission access. Because Texas is poorly interconnected with other states and the demand for electricity is rising briskly, the state will need much future generation in future years unless it embraces conservation measures. TXU's pact with Mitsubishi, announced last month or after the boycott, is somewhat sketchy, because Mitsubishi's computer design – the US Advanced Pressurized Water Reactor or US APWR – hasn't been certified for US use, unlike reactors from Westinghouse Electric, controlled by a consortium led by Japan's Toshiba Corp.

"Nor does TXU have permission to build yet. TXU wants a new reactor in operation by 2015. TXU says its goal is to build reactors at a 30% discount a unit discount, per unit of capacity to what rivals spend. That is the same goal it espoused last year when it espoused plans to build 11 coal-fired plants. This TXU claim has led to some skepticism by rivals who view it as a publicity stunt.

TXU says it will achieve savings through 'lean manufacturing' techniques, but other firms are expected to do likewise."

Concern with propaganda and what can likewise be described as lean manufacturing led to the Soviet Union's Chernobyl disaster that resulted in making some 5% of the Ukraine uninhabitable for the next few thousand years.

"In the past, some nuclear plants cost time 10 times as much as originally projected."

"It is too early to tell how the public will react, but many environmental groups are rethinking their position on nuclear power. Jim Marston, an attorney for Environmental Defense in Austin, says his group 'has reservations, but we think global warming is so severe and the time for action so short that we're willing to take another look at it.'"

Humanity may still pay a shattering price for allowing its economists to ignore the environment as an "externality."

William Krehm

Commission *continued from page 2*

with maintenance or for modernization is a familiar provision in mortgage financing. In no way does it require the sale of properties. The sales program is unquestionably to provide the means for the financial sector recouping future speculative losses elsewhere and to meet the scheduled growth of earnings on which the value of options granted high corporation brass depends.

So much basic to the legislation still on our law books has been disregarded or actually violated, that nothing less than a Royal Commission is needed to set matters right again. It would undoubtedly be useful in sorting out fact from fiction in what passes as information on which all parties base their policies.

Several Royal Commissions led to the establishment of the BoC in the first place. And the existence of a *Bank of Canada Act* intact on our law books, but disregarded by our legislators, is anything but reassuring. Nor is the departure of the current Governor of the Bank of Canada without even seeking a second term. There is too much afoot in our financial policies that contravenes our legislation. Too many ideas of the greatest economic thinkers most relevant to our problems have been suppressed from our university curricula and our media, not to recognize the need for an adequate reassessment of the policies that have led the world to the brink of a precipice.

William Krehm

Banks Must Expand Ever More Recklessly

Banks, it would seem, must grow ever more recklessly because there is nothing so dangerous as not doing so in a jungle. Monumental greed, however, does contribute to this troublesome trait. But there is more to it than that. Have you ever contemplated what happens when a city from a semi-rural cluster of smallish buildings, moves on to become a highly commercialized center of several million inhabitants? Or when the Americanization of Europe and Asia takes place with skyscrapers replacing the old three- or four-storey buildings that existed before the American pattern took over?

Skyscrapers from the moment they are planned and the zoning changed to permit them, cause the value of the buildings in the adjoining area to increase vastly, depending in part on their use, but also on the life styles and resources of the financiers and actual occupants of the new structures. Sites in the area with an eye on possible future rezoning, or due to the facility of getting to and away from them when new transportation facilities have been brought in, have only a single direction to move – in the longer or shorter term.

In all these respects there are two categories of additions to the wealth added that must be given breathing space to grow on its own – what is actually built and what has the potential for being built on, that meanwhile contributes to multiply the amount of current value involved that must be taken care of. That means a huge leap in the growth that has come to be considered the norm in our economy.

And when one culture – say that of the US invades London or St. Petersburg, possibly at a certain esthetic cost, that multiplies the capacity of a certain urban district to hold or service a far greater population, and the end result is the explosion of the mass of monetary wealth. Even the Coca Cola signs that may deface the facades of classical European cities, add to the monetary wealth of the economy, to which the Lord's sunsets and sunrises that the flashing signs hide may have contributed far less.

Clearly banks will feel called upon to handle and profit by this explosion of monetary activity. And that is the background that we must summon to fully appreciate the clash of banking styles overtaking Europe and Asia today. And at this point, let me turn the story line over to *The Wall Street Journal* (23/04, "Amid European Fray, Biggest Bank Deal Ever" by Carrick Mollenkamp, Edward Taylor and James Singer): "For months plans for the world's biggest bank merger unfolded at a stately pace between two European chieftains.

"After quietly polling other European banks, Rijkman Groenink, chief of the Netherlands' ARN Amro Holdings NV, settled on Barclay's PLC. In Barclay's CEO John Varley, Mr. Groenink found a partner who promised not to break up the sprawling ABN and accepted Mr. Groenink's demand to keep the bank's headquarters in Amsterdam."

The Long-awaited Merger of European Banks is at Hand

"The long-awaited unleashing of bank mergers in Europe is at hand, promising to reshape the industry as the continent's financial giants yield to the lure of size and global scale. But it isn't happening in the orderly fashion Europe's bankers expected, as hedge funds and other activists plunge in and try and shape the outcomes.

"As early as today, ABN is expected to unveil an agreement to be sold to Barclays for about $90 billion. Instead of celebrating the finale that Mr. Groenink envisioned and the creation of one of the world's biggest banks, Mr. Groenink is scheduled to meet this afternoon with potential hostile rival bidders, as he comes under pressure from shareholders to consider other offers. If the rivals – a consortium of Dutch-Belgian Fortis NV, Spain's Banco Santander Central Hispano SA, and Britain's Royal Bank of Scotland Group PLC – win ABN, they will break it up.

"To block the consortium, Mr. Groenink over the weekend made a concession he had long sought to avoid: selling part of ABN. He agreed to sell its US bank, LaSalle, to Bank of America Corp. for $21 billion.

"Wielding an aggressive takeover defense, ABN calculated that by jettisoning LaSalle, it could make itself unattractive to the consortium. With so many complications an ABN-Barclays could still fall apart.

"Across Europe big banks are finally succumbing to the pressure to join forces. With

their home markets saturated they want to expand into neighbouring European markets as well as into Eastern Europe. And also into Brazil and India where customers are rapidly taking up credit cards, mortgages and other services. They need to compete with the large American banks, which after their own merger boom of the last decade are also eyeing new territory.

"Just last week, Italy's UniCredit SpA said it was conducting preliminary talks with France's Société Générale SA about a possible tie-up. The two banks have worked together for years. Yet those talks, too, could get more complicated. Rival French bank BNP Paribas SA, long seen as a merger partner for Société Générale could join the fray, people familiar with the matter said.

"As they seek friendly deals, European CEOs risk putting their companies in play, exposing the banks to unwelcome suitors or losing control of the sale process."

Flush with Cash

Activist hedge funds, flush with investor cash, but under pressure to generate high returns, are stirring up investor support for higher bids. "If Barclays fails to win ABN, it could become an acquisition target itself. Indeed, to get support for the ABN deal, it has made a strong case that it needs a partner. One possible suitor is Charlotte, NC-based Bank of America, whose CEO said last week that Europe is on his radar.

"Royal Bank of Scotland Chief Executive Fred Goodwin told bank analysts that the consortium won't shy away from making a hostile bid, a very rare occurrence in banking, at a dinner last Thursday night.

"Mr. Goodwin is one of the few bank chiefs in the world who have done a hostile deal, his 2000 purchase of National Westminster Bank. Helping him now are his close ties with Santander Chairman Benjamin Botin. Their banks have had board directors in common and stakes in each other. By bidding in a pact, they can divvy up ABN.

"Already the consortium is making a deal harder for Barclays, because it is driving up ABN's stock price. ABN shares in Amsterdam have risen 33% since Barclays first disclosed on March 19th, that it was in talk with ABN.

"Barclays promised to keep headquarters in Amsterdam. Known as Britain's most refined bank with its hires for years from Oxford and Cambridge universities, Barclays has roots dating back to 1690.

"Barclays also wanted to expand overseas. In 2003 at a board meeting after he took over as CEO, John Varley declared that the bank would be landlocked unless he were authorized to pursue deals. They did so.

"As Barclays and ABN inched closer to a deal they were sideswiped. A :London hedge fund, the Children's Investment Fund Management LLP, known as TCL, was readying an attack on ABN.

"Founded in 2003 by Christopher Hohn, TCI is a high profile stock investment fund with a philanthropic twist. A slice of its management fees and profits goes to an organization run by Mr. Hohn's wife, which donates to causes including President Clinton's foundation and a Kenyan project that fights HIV, according to the charity's website.

"Mr. Hohn and his small team buy shares and then lead public campaigns to pressure management to change or do some sort of deal. Mr. Hohn figures that ABN's parts would be worth more than the whole 'It was apparent that ABN AMRO's management were not responding to shareholders' concerns,' says Mr. Hohn, in an e-mail response to questions. It was apparent from the jump in trading of AMRO on the stock exchange following that e-mail that his long-term investors were bailing on him.

"Mr. Groenink turned to Barclays CEO and gave in on an issue that had bogged down their talks. Mr. Varley could be CEO of a combined bank, and Mr. Groenink is not expected to plan active leadership role. Barclays feared rival bids would emerge. Citigroup Inc., thought to be interested in ABN, joined Barclays' bid as a merger adviser instead. Goldman Sachs Group Inc., which was working for three banks, Fortis, Royal Bank of Scotland and Santander. Together they could pay more than Barclays for ABN. It was as though in a jungle the lions had settled for a role as advisers to the tigers on hunting tactics. Signaling that Europe's banking deals would continue, some of the banks also have said, they would be willing to take a look at assets were Mr. Varley to sell them."

W.K.

Debt-Driven Problems

Analysts have started rating a stock's value not only according to its profit prospects, but also by the chances of it being bought out. And in many cases, companies are responding to the possibility of a buyout by issuing debt and buying back their own stock to boost the share prices and to placate restless shareholders, and heightening the prospects of such a bailout.

From *The Wall Street Journal* (4/18, "Dow Industrials Regain Ground On Buyout Wave" by Justin Lahart and E.S. Browning): "The enormous amount of money that buyout specialists command puts a safety net under the market,' says Byron Wien, chief investment strategist at hedge fund Pequot Capital Management. More than $435 billion in buyouts were announced in 2006 according to Thomson Financial. That figure includes the debt owed by target companies when the deals were announced. So far in this year almost $183 billion more in buyouts have been announced, putting the buyouts in 2007 on pace to surpass $700 billions. That compares with $99 billion in 1988, at the height of the 1980s boom.

"The irony is that the stock market is celebrating a process that removes companies from the public's reach. On a simple supply and demand basis, that decreases the overall supply of stock, pushing up prices.

"In each of the past three years, more stock has been withdrawn from the market through buyouts and corporate share buybacks than has been issued. Last year, a net $548 billion in US corporate stock was taken off the market, up from $295 billion in 2005, according to the Federal Reserve.

"Owning the shares of a company that becomes the target of a takeover can lead to instant gains. Last Friday the shares of Sallie Mae – based partly on government student loans – rose 15% on reports that it was in buyout talks. It rose another 18% on Monday when the deal was announced." Talk of black magic – however, with the students whom the underlying government loans were supposed to help, being the source of this effortless gush of profits!

"Private equity investors say they are making these companies more efficient. But Mr. Wien has his doubts. If you're an LBO (Leveraged BuyOuter),you don't have the same long-term focus that you do if you are running a company for eternity,' he says."

Fast profits, the faster and bigger the better, are the main concern, and in the process of attaining that goal society is forgotten and trodden on.

W.K.

Precious Advice to Western Auto Giants from the Humble Chinese

Some auto giant corporations have picked up some free, highly profitable advice from the more humble Chinese. *The Walls Street Journal* (30/04, "For GM in China, Tiny is Mighty" by Joseph B. White, Liushou, China) reports: "In this 2,000-year old industrial city in southwestern China, General Motors Corp. is thinking big about small vehicles.

"Liushou, a metropolis of more than three million people about 1,200 miles west of Shanghai, is home to SAIC GM Wuling Automobile Co., a maker of commercial minivans and the Chevrolet Spark minicar. Wuling's vehicles are tiny – the best-selling Sunshine vans, at 1,030 kilograms, is of about one third the size of GM's Chevrolet Tahoe sport utility vehicle.

"But Wuling's sales growth has been sizeable, Since 2001, the year before GM acquired a 34% stake in the company, Wuling's sales have more than tripled, to nearly 460,200 vehicles last year.

"GM's increasing concentration on the brand reflects a broader competition among big global auto makers, that have seen sales stagnate in Western Europe and the US, to tap interest in smaller, inexpensive vehicles in big growth markets such as China and India. Through Wuling, GM, maker of such iconic vehicles as Chevy trucks and Cadillacs, is rethinking the idea that small cars equal small or no profit.

"Government regulators, world-wide are demanding more fuel efficiency to reduce CO_2 emissions linked to climate change. In China, the government levies a graduated tax on vehicles tied to engine size – 9% for a 2.5 liter engine, compared with 3% for engines less than 1.5 litres.

"At the same time less-affluent consumers in such lands want inexpensive vehicles that offer comfort, style, and safety. A study by automobile consultants at Roland Berger estimates that by 2012, 1.6 million motorcycle owners in developing markets will want to switch to cars – mostly small, inexpensive ones, costing less than $13,500 US will grow to 18 million vehicles a year by 2012 from bout about 14 million at present.

"French car maker Renault SA has scored a hit with a low-cost car called the Logan, which sell for less than $10,000. As of this year, the car will be sold in 55 countries, including India, Argentina and Brazil. Since the Logan's launch in 2004, Renault has sold more than 450,000 of the vehicles.

"In China inexpensive small vehicles can start at less than $4,000. The starting price of a Wuling Sunshine car with a one-liter engine is $3,700, about the low-end price of a low-end Chevy Spark.

"The growth in GM's Wuling comes as the Detroit auto maker looks to emerging markets to offset declining US market share. The World's No. 1 auto maker by production sold 2.20 million cars and trucks around the world in the first quarter, up 3% from the year earlier period, driven by sales in Asia and Latin America."

China to Use Technology Acquired in Partnerships

"Wuling is 50.1% owned by Shanghai Automotive Industries Corp., GM's main partner in China. The rest is held by the state-owned Liushou Wuling Motors Ltd.

"GM and SAIC GM-Wuling executives say they plan to finish by next April the expansion of a factory in northern China that will increase annual production capacity as much as from 500,000 to 700,000, At that rate Wuling will be one of GM's best-selling brands world-wide – bigger than Pontiac or Saturn. Since 1999, revenue at the venture has climbed to 15 billion yuan from 2,34 billion yuan.

"Since sales started in December Changan BenBen has become the No. 2 seller in China's booming minicar segment after the Chery QQ, says Zhon Qin, a Changan spokesman. Changan has sold more than 20,000 BenBens nationwide, and monthly sales now average more than 6.000 to 7,000 BenBens, he says. Automobiles are now going to mass consumers. They are no longer luxury products.

"James Hu, head of Wuling's marketing, says the target customers for inexpensive vehicles like the Wuling Sunshine microvan are mainly Chinese farmers and workers of small businesses living in lesser towns.

"Wuling is getting its brand name out in these areas through marketing strategies like sponsoring film screenings in where movies are scarce. Many of Wuling's customers earn the equivalent of $200 to $600 a month, and don't own cars or vans. They get around on bicycles, scooters, or motorized, three-wheel vehicles with carrying space.

"At Wuling's main manufacturing complex here, a new building houses an engine factory built to the same specifications as a modern GM plant, company managers say. Workers in blue uniforms do much of the welding by hand – work that is done with robots at Western GM places. But that often makes sense in locations like Liushou, where labour costs, including benefits are well less than the $9 dollars an hour GM says it pays in Shanghai. GM executives wouldn't say what labour costs are in Liuzhou.

"Longer term, the company plans call for Wuling to be a 'strong competitor globally.' But Mr. Drumgoole, an American who came to Luizshou from GM, says Wuling's main priority is meeting demand in China.

"Luizhou's political leaders, meanwhile hope booming demand for Wuling's inexpensive cars will allow more Wuling workers to afford the vehicles they make."

That seems to be the key lesson that China's boom demand for cheap, good cars has had for the auto concerns, the government, and its economists. It was one that the West had learned through the hardships of the Depression, the war, and the first prosperous quarter of a century of reconstruction to standards undreamt of in the 1920s, when every car worker in fact could afford a car and much else. Since then it has been forgotten when our governmental bureaucracy decided for us, that it was more important to give our banks the freedom to gamble in non-banking areas such as the stock market, insurance, and real estate mortgages.

What the Chinese seem to be unearthing is that adequate purchasing power in the hands of both those who work in the real productive economy, must provide adequate market demand for our producing corporations. More than the rescue of the world automobile industry hangs from the ability of our governments to grasp this insight of the officialdom of Liuzhou. Try to imagine Detroit in its prosperous age, but with the auto workers unable to afford a vehicle produced by themselves or their comrades. Economics cannot really be that obscure and forbidding unless its has gone bankrupt like so many of our major auto corporations.

William Krehm