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A Risk-sharing Partnership of Government and Corporations in the Oil Sands

The Globe and Mail (13/10, "A Deep Well of Discontent" by David Ebner) parsed the great shift that Alberta was about to make. From essentially a gas producer running out of gas, it is venturing into the costly oil sands where the unknowns extend from unaccustomed technologies to a world energy market running out both of gas to burn and unpolluted air to breathe. The choice then is not just what royalties to level on the corporations venturing into the oil sands, but what revenue the government will receive and when from the province's last great energy resource. The best way to foretell our future is to study our past. And with new technologies taking over in basic industries, new groups tend to come into power. That is what brought Ralph Klein to power as a struggling agricultural province suddenly found itself wealthy in gas and oil resources some three decades ago."

Unlike his predecessor, Ralph Klein, there is no intimacy with Calgary's Petroleum Club, to help assure his successor decades in power.

"When Ed Stelmach unexpectedly became Premier of Albert last December, a quiet but important shift occurred. Power moved from Mr. Klein's home base in the energy capital to Mr. Stelmach's traditional territory, rural Alberta.

"Mr. Stelmach has hardscrabble roots on a farm neat Edmonton that his grandfather settled in 1898 and that he returned to in his early twenties to work instead of going on to law school after an older brother died unexpectedly. That turn back to the farm put his grander ambitions on hold, yet he slowly but surely arrived there without years of hanging around the Petroleum Club.

"Today Mr. Stelmach is poised to make the most important economic decision in the country this year, promising by month's end what's fair for energy royalties.

"A decade from now, conventional oil and gas production – and royalties from these sources – will no longer form the basis of Alberta's treasury. The province is depending on the oil sands to make up the difference, as production in the region roughly triples. Without this, Alberta would slowly skid towards the have-not provincial status it held before the discovery of a giant field of conventional oil near Edmonton in 1949.

"When the six-member review panel came out with its report on Sept. 18, the surprise was not that it called for higher rates in the oil sands, but that the main target for immediate increases was the struggling natural gas business. The critical and most controversial issue – natural gas – has underpinned Alberta's economic success and its overflowing treasury. The so-called Calgary oil patch is in fact a gas capital, with a shift only now beginning to swing to the oil sands. Canadian Natural Resources Ltd., the country's second-largest producer, is the embodiment of this evolution. Beginning in the deep recession of the later 1980s as a scrappy gas producer and growing into a giant gas producer – it is now making a giant bet on the oil sands."

But the oil sands remain a tomorrow story, a key source of the province's long-term revenues.

"There are more than 100,000 producing wells in Alberta, but it is only a very

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few small number that really count, those that dot the rugged foothills of the Rockies. Mr. Stelmach's decision this month is absolutely crucial for winter drilling in these foothills – the short window lasting a couple of months when the ground is frozen to move rigs in and out to hunt for the few remaining big gas targets buried thousands of meters beneath the surface.

"The royalty review panel felt the province wasn't getting its fair share from these big gas wells, which spit out piles of cash at higher prices, but can also cost millions of dollars to drill (and successful drilling is far from assured). The panel said its recommendations would in fact see royalties on about 80 per cent of gas wells reduced at recent gas prices aiming to encourage production of modest wells, but those tiny wells are a secondary concern in the bigger picture.

"Under the recommendations, the prolific gas wells in the Foothills – those that uncover major reserves to heat homes across the country – would see their value slashed to 59 cents per million cubic feet from 98 cents as government takes more money up front.

"Pedro van Meurs, a respected international consultant on royalties upon whom the panel relied heavily, indicated in a July report that Alberta had 'considerable competitive scope' to get more when gas [or oil] prices are high. But he added that deep wells in the Foothills generally require high initial output to justify drilling them, suggesting that taking more up front 'may not deal effectively with deep gas wells.' He recommended further investigation of incentive programs to encourage such drilling.

"At current natural gas prices, with the panel recommendations, drilling in the Foothills makes no economic sense, according to Canadian Natural and all the other leading explorers in the region. It is why Canadian Natural said it would slash spending by $800 million next year if the recommendations are fully adopted. It is why Encana Corp. announced its intention to take $1 billion off the table. It is why Talisman Energy is mulling a $500 million cut. And Conoco Phillips Co. plans to withdraw another $500 million.

"The royalty panel envisioned its recommendations quickly adding $2 billion to the provincial treasury.

"Still don't cry for the poor natural gas explorers. They are playing a game of big risk and big reward, and the rewards can be fantastic. Natural gas fuelled Encana's $6.4 billion profit last year, the biggest in Canadian history, not to mention Talisman's $2 billion take, its best ever."

"Because Ralph Klein capped gas royalties in the early 1990s at very low levels, wells in the foothills can produce excellent rates of return of more than 15% at higher prices such as $9 per thousand cubic feet. The panel's recommendations would cut that to 6.5%. In between is the balance Mr. Stelmach must strike and the executives are ready to deal. Canadian Natural this week issued the most detailed assessment of what the royalty proposals mean to the business, warning of job losses for 4,000 contractors as it slashes the number of gas wells it might drill in 2008 to just 88 from 253 this year."

A COMER Solution Based on Government Risk-free Assumption of Initial Oil Sands Risk

At this point COMER must enter the discussion in a decision that will effect every Canadian across this land. Were it a play on the stock market, bundled packages of phony "managed risk" would likely be issued, with eventually the government left paying much of the losses. But here is a situation where the federal government – with the full backing of the province – could put itself in a most unusual situation. What is risk to the oil companies is in fact of no or little risk to the Alberta and Ottawa governments. The cost of thousands and thousands of workers being thrown out of work, the social and monetary bill for fuel shortages across the country for homes and industries, is staggering. Have the province with full backing or partnership of the federal government offer to enter as a partner in all oils sands deals with a minority interest for the riskiest swath of risk for the private companies. For the governments there would be compensating rewards in economic saving in avoiding unemployment, social and fuel problems if those essential wells are not drilled. What would be risk for the private companies could thus well turn out risk-free and even profitable for the Alberta government if it took over that initial risk of dry or mediocre wells, and very substantial gains if the drilling proved successful. Contracts could be designed whereby the provincial (and possibly the federal government) could appear as important partners during the riskiest stage of development of wells. The disproportionate risks assumed by the government at this critical point could be financed by the Bank of Canada, since the entire cost of the drilling will be spent in paying the salaries of Canadian workers and using Canadian

materials. If a well proves insufficiently productive it can be abandoned, with the whole or a disproportionate portion borne by the government shareholder, which ought not to exceed 49%. Once a well is proven, the government may either continue as partner for the same proportion or have its proportion bought out at a higher price than before the well has been proven productive.

The use of the Bank of Canada for such purposes was established by Gerald McGeer away back in 1935 – long before Keynes – even to the extent that he ever did – reached similar conclusions. That is because money borrowed by the federal government from the Bank of Canada returns to it substantially as dividends. The provinces may, too, borrow from the Bank of Canada. But since they are not shareholders of the central banks the interest paid on such loans do not come back to them as dividends, but some arrangement can be reached with the federal government for sharing the financing benefits through the central bank. That, of course, would be credited to the federal government in whole or in part depending on the arrangement reached in the negotiated deal between the two levels of government.

Note this well: At present our federal government is engaged in selling off invaluable downtown real estate across the land to private parties because it claims – incredibly – that with a wholly-owned central bank at its disposition it could not afford to maintain the downtown buildings so it has to sell and lease back for 25 years buildings that it wholly owns. Such buildings, because of their location, cannot fail to rise in value steadily reflecting any upgrading of infrastructures undertaken by any of the three levels of government.

By stepping in – both to call the possible bluff of the private oil companies, and to meet their real concerns about the early risk during the development of the high-risk wells in question – the Alberta government will be reversing the surrender of public interests in a highly crucial situation. That this would be done in partnership with the private sector is a welcome feature, since it will lower the risk borne by the private companies through a virtually risk-free participation of the two levels of government. That, moreover, should help Premier Stelmach amongst his farmer constituents.

It would help usher in a fairer, franker epoch in Canadian politics. Let us not fail to make the most of a most unusual opportunity for national cooperation.

William Krehm

Multiple Ways of Skinning a Cat

There are various ways of skinning a cat, but no matter which of them you choose, you at best end up with. not mink, but catskin. As witness to that we can put kitty in the dock, and have her testify.

This case has to do with the subprime mortgage mess based on "risk-management" applied to bundling mortgages together and then marketing swaths of risk according to the investor's taste. The outcome is basically determined (1) by the amount of supervision that some government authority is allotted over the process; (2) the funding that accompanies the authority entrusted with the supervision of a given area of mortgage lending and banking controlling the type of corporation involved, or has the motive and means to assure neutral judgment in such a mission.

In examples we have chosen the government put in charge the Office of the Superintendent of Financial Institutions (OSFI). Our source of information is volume 1 of *Meltdown: Money, Debt and the Wealth of Nations*, which follows the record of OSFI up to 1999, and was published in 1999. The second, third and fourth volumes will be appearing in coming months to bring it further up to date. In volume 1 there are nine entries referring to news items in which OSFI for one reason or another made news during the decade of the 1990s.

As early as June 1995, *ER* picked up the following item: "In the words of *The Wall Street Journal* (14/04) Charles S. Sanford, chairman of Bankers Trust has inspired the transformation of banking. Mr. Sanford decided to move away from traditional banking by focusing on a business called 'risk management.' Henceforth banks would not only manage risk but help create it on a world scale. He preached the idea that everything in life involves risk and that Banker's Trust could help companies recognize, quantify, mitigate and even capitalize these risks [as a virtual asset]. He claimed that derivatives could be used for everything from hedging risks and investing money to creating 'synthetic mergers' and acquisitions. The really smart would simply place bets on what would happen as the less bright wasted their time growing wheat and manufacturing widgets.

"In an address at the University of Georgia in 1989 Charlie proclaimed the philosophy of the new banking: 'The real risk in life turns out to be the refusal to take a risk.' If you are feeling slightly dizzy at this point, don't take it amiss. You have simply been maneuvered into standing on your head and getting matters upside down."

Charlie Sanford Restructures the Banking World

"Among the converts to the theses Mr. Sanford nailed to his bank's doors were Canada's Royal Bank of Canada and the CIBC. Recently we reported their hiring wholesale the derivatives specialists of US financial firms come to grief following Charlie walking on water.

"In the words of *WSJ* the Bankers Trust 'has stumbled badly and it now faces new problems so serious that its future may depend on Mr. Sanford inventing it all over again.'

"Yet there was some logic in Canadian banks jumping into the derivative sea where BT was already sinking. To bail Canadian banks out of their massive losses in the eighties, Ottawa relieved them of the need to hold non-interest-bearing reserves with the Bank of Canada in support of their deposits.... They are thus better-positioned than the high priest himself to convert his gospel into clinking coin.

"However, Canada's Auditor General, Denis Desautels, worries about 'the capacity of OSFI to evaluate credit risks facing the banks from derivatives and securities activities' (*G&M,* 5/12). Yet the BoC still opposes the regulation of derivatives.

"Fortunately Charley's fertile mind has come up with a cue for dealing with this. 'I think we should get rid of our commercial bank licence.' Those who insist on acting out Charlie's evangel should be asked to trade in their banking licenses for casino licenses more in keeping with the business of their choice."

Before we proceed to the next piece of evidence, let us note an important detail: had the government of this land responded to this bit of news that we highlighted over 12 years ago the current costly banking crisis could have been entirely avoided.

However, for a further sampling of how *ER* (08/1997, reproduced in *Meltdown*, volume 1, page 262, under the heading "Have the Banks Taken Over Our Government?") could have saved the Canadian taxpayers billions of dollars.

Whatever illusions about the state of Canada's democracy survived the elections are taking a brutal pounding. The elections were spun almost wholly around the deficit. The major parties did not so much as mention allowing the banks to merge. Yet even before the brief campaign was halfway through, the *G&M* (14/05) reported a task force on financial legislation being "pledged" to let the free market operate with as little government intervention as possible. "Pledged" by whom, to whom, and with a hand on what bible?

"The background of the Task Force's original chairman suggests the answers. Mr. James Baillie comes to us neither from banking nor from supervising banks. A lawyer, he served as head of the Ontario Securities Commission whose job is to keep the Toronto Stock Exchange pure. From abundant evidence before and since his departure from that post in 1990 – his success at that task left something wanting. In the midst of the election campaign the case of Bre-X shook the world. for the extent of the fraud involved. An Indonesian promotion headed by a recent bankrupt that did its mining in investors' pockets rather than in the ground, was not only listed on the TSE but was included in the basket of stocks on which the index is based. It is has been described – we cannot say with what degree of justice – as the greatest bit of crookery in the history of mining. But then we do live in an age of superlatives.

"The response from those with a background in bank regulation has not been slow in coming. On June 25, Michael A. Mackenzie, former head of OSFI, addressed the Conference Board of Canada on 'Ownership Rules and the Future of Banking in Canada.' His central point was the increasing vulnerability as they race to become bigger.

"There is no responsible government in the developed world that does not take a strong interest in the prudential supervision of major banks and will [not] go to great lengths to ensure that they do not fail.... It is interesting that nowhere has this 'too big to fail' doctrine been put into writing. Learned academics, journalists and stockbrokers in love with open markets are claiming that banks are no different from other sectors and that ownership restrictions have no place in the global economy."

Let us eke out the meaning of Mr. Mackenzie's remarks – for "the too big to fail" principle is not the only crucial detail about banking that is rarely mentioned in polite society these days. Remove the 10% ceiling on shareholdings in banks and our mega-banks from six would soon become five, four, etc., to a single one. En route the urgency of our not allowing them not to fail would become greater. And why should a government that has been so diligent in slashing social and other services embark on such a path? What could be behind the lemming dash to elevate having the world's largest bank a national priority?

In 1991 when our banks were up to their nostrils in bad loans from financing leveraged buyouts, speculative real estate empires, a bill was slipped through a dozing Parliament phasing out the statutory reserves that banks had to put up with the Bank of Canada as a proportion of their deposits. These reserves earned them no interest. For years before and after the Second World War such reserves had amounted to 10%, but by 1991 they had already been whittled down to about 4% or less. With their abolition, the ratio of the total credit the banks could create to their legal tender had been increased in the general direction of infinity.

Banks don't like holding cash (legal tender). Since it earns no interest, they consider it sterile money.

Our Birth Rate is Falling but It is Sterile Money that has Caught our Government's Sense of Priority

Our birth rate may be falling, as potential mothers must go out to work, but it is sterile money that has captured our governments' sense of priority. And with the end of statutory reserves the only cash they still hold is what they need to meet their net cheque clearances each day with other "clearing banks" and to stock their ATMs. Were our six mega-banks reduced to five such "leakage" would be lessened. Moreover, allow one merger and you are committed to allowing all. You will end up with a single private bank, with all cheque clearance become an internal affair tying up no legal tender at all. And that single leak-proof bank could gamble its head off, secure in the knowledge that it had become "too big to fail." The government would be ever there, like a doting uncle, to pick up the gambling tab.

Even before the phasing out of reserves, the Bank for International Settlements had in 1988 published its *Risk-Based Bank Capital Requirements* that declared the debt of OECD countries "risk free" requiring no capital for the banks to own. At the same time they were relieved of the need to keep over $2 billion in cash with the Bank of Canada.

The banks have moved away from banking In 1946 the ratio of our banks' assets/liabilities stood at 11:1. And then by 1996 it had soared to 292:1. Not only had the leverage gone wild, but an increasing proportion of the investments consisted of pieces of entire banks throughout Latin America, brokerage houses, a heavy involvement in derivatives for their own and clients' accounts, overstretched credit cards, and much else.

Mr. Mackenzie avoids scarlet words, but goes far towards spelling out the reality. "In all but name, [our banks] have become universal banks have become financial conglomerates, doing business on its own books or through affiliates: domestic commercial and retail banking, property and, mortgage banking, securities underwriting and stock-brokering, mutual funds, transacting derivatives and foreign exchange products, and casualty insurance." While the talk is all of "level playing fields," the playing field is in fact practically upended for the banks' overweening ambitions.

Mr. Mackenzie examines the objectionable features of a "closely held" financial institution. "The business objectives of the major stockholder drives the capital and the bank's business strategies. More frequently than not, the controlling shareholder wants to tap the deposit base of the bank for other objectives. There should be a separation of banking and commercial and industrial interests."

The High Explosive at the Heart of our Government's Stabilisation Policy

The combination of ending statutory reserves and deregulating what banks can invest in is lethal. It will guarantee us deficits from bailing out banks, credit crunches and recessions for decades to come.

If you think that we are exaggerating, just note how events have changed their speed and course since Mr. Baillie's initial release. To quote *The Globe and Mail* (28/6), "Until this week James Baillie thought he had another 14 months to ponder the future of Canada's financial sector. On Tuesday, the day that talks between the Royal Bank and the Financial Corp. [for the merger of the Bank with London Insurance], Mr. Baillie was asked to come up with criteria the government can use in approving mergers and acquisitions by July 11. In an interview Mr. Baillie said that it was regrettable that there will no longer be enough time for broad

public consultation on the issue of mergers because it is difficult for the legislative process to keep pace with market events."

And then the *G&M* (4/07) reported chairman Baillie "involved in one of the deals that caused Ottawa to seek his Task Force's advice on what rules should govern mergers": the takeover of National Trust by the Bank of Nova Scotia. Mr. Baillie, it appears, was a director of Midland Walwyn Inc., a brokerage, and Manufacturers Life Insurance Co. when he was appointed to chair the Task Force.

Meanwhile, we are surprised to learn that bundled and syndicated risk for "management purposes" is not only directed to get impecunious folk into buying homes that they can't afford by means of shifting mortgage repayment arrangements, but is entangling banks with the other "financial pillars" – the one great lesson that the world learned about how not to run a bank during the Great Depression of the 1930s.

William Krehm

Quality of Life and the Price of Gold

Immediately after the evening news there is a barrage of information about the stock market. News of the current level of each stock exchange is concluded with the joyous ringing of bells.

For those people fortunate to own a variety of stocks and some gold, and want to know what is going up or down, this news is exciting. The business section of newspapers offers even more information with many pages listing various stocks. The TSX, the NASDAQ, S&P and stock markets around the world are followed daily along with the price of gold and of oil (black gold). Do you feel better when you know the market is going up? Are you depressed when you note that the price of gold is down?

Of course investors can win even when the price is down if they had bet correctly on the future. So everyone on the TV screen is smiling as the bells rings at the market closing each day. Of course it doesn't really ever close: buying and selling is a 24-hour per day, 365 days a year process thanks to the internet.

Most people in the world are not part of this excitement, most cannot afford to own stock. Even in the US the percentage of people owning stocks in any form is under 50. The stock and gold investors and the poor live in separate worlds, or do they? What are the things that most people should want to know so that they can plan their lives? Could some of these be better reported in the news?

Gold exploration and mining can be a bonanza for investors while at the same time a disaster for some. When Bre-X Minerals Ltd. was found guilty of fraudulently sprinkling specks of gold over core samples the biggest losers were the investors who lost three billion dollars (US). Toronto has benefited from the profits of Barrick Gold with the donations of CEO Peter Munk to the Munk Centre at the University off Toronto and the Peter Munk Cardiac Centre at the Toronto General Hospital.

In Columbia the British gold mining company Anglo American has been accused of profiting from persecution, intimidation and killing of people opposing their mining. Army operations have benefited the mining companies as traditional small scale less polluting gold mining is replaced by big company exploration and extraction and the use of cyanide in the process. South Africa's gold and diamonds do not seem to have benefited most of the people.

The Quality of Life? Whose Life?

So quality of life depends on whose quality of life one considers. It can go up with the acquisition and sale of more gold or down for those who are robbed of their land or face the cleanup after the mine closes.

Why is it that business news dominates the media? Linda McQuaig, *Toronto Star* columnist and author of *Holding the Bully's Coat: Canada and the US Empire* explains that it is not just the direct business reporting but the influence the business mindset has on all the news.

Top of the list of concerns today is climate change. Depending on whom you listen to reduction of CO_2 levels will ruin the economy or will bring in millions of jobs and big profits. Former President Bill Clinton is sure the economy will benefit.

Climate change gets our attention in news about the weather each day. But shouldn't we also be interested in the level of the oceans? Al Gore's film *An Inconvenient Truth* shows very graphically how low-lying lands around the world will be flooded as the ocean level rises. This would be difficult to report in any useful way but the incidence of hurricanes and fiercer storms is newsworthy and can be linked to the climate change scenario. You live on high ground so you're not worried? Think again. Where do you suppose all the people being flooded out are going to want to go? The reporting on Katrina demonstrated the extent to which most countries, even rich ones, are not prepared ahead of time and are unwilling or unable to rebuild afterwards. Katrina also had some lessons for American economists. The capitalist system could not, or would not, rush to the aid of the flooded poorer sections of New Orleans. What did rush in were Charter schools to replace the devastated public schools. Similarly with the tsunami in Sri Lanka when the beaches were devastated the fisherfolk were not allowed to return to their beach fishing huts for safety reasons. Only large foreign hotels are being allowed in so that the area can become another haven for the sun-bathing rich.

Climate change will force us to use new technologies of sun, wind, geothermal and yet-to-be discovered sources of energy likely to increase our quality of life. The bad news needs to be offset with all the good news of smog-free air, unmolested nature and profitable climate-friendly business.

One emerging big business is in bottled water with no thought for the environmental consequences of millions of oil-based plastic containers being dumped, Coca-Cola is struggling to control the water supplies it needs for its business in spite of opposition in water-short countries.

We in Canada, a land of lakes and rivers, have a difficult time responding to the need to conserve water. But many countries are experiencing a reduction in the level of water in their aquifers. Water use, vital to people, farms and industries and to the quality of life generally is interfering with the ability of aquifers to replenish naturally.

Our Immediate Concerns Must not Stop There

Of course most people would rather think about their own immediate concerns such as employment. And the press does give figures on unemployment and bankruptcies. More news on the causes of these trends would help us determine our own futures. What are the best types of jobs for those entering the job market? Why are

some companies going bankrupt? Is there a global trend in unemployment and underemployment? Will our investments in the stock market help create jobs in poor countries or have they actually reduced the number of good jobs through downsizing to increase profits?

Canadians list health as a major concern. So we do read about the latest global pandemic realizing that diseases like SARS can come to our city very quickly. But do we get all the information we need on health conditions of people around the world, realizing that this can affect our own global businesses as well as our health? The AIDS pandemic is in the news because we have a new connection with Africa with the Grannies-to-Grannies initiative of the Stephen Lewis Foundation. But we are behind in our ability to address the problem or even to think about the tuberculosis, malaria and other diseases more numerous even than AIDS and more easily treated with modern medicine. It too quickly becomes "old news."

When the UN wanted to assess the condition of people around the world it produced Human Development Reports. These measured the following: life expectancy at birth, infant mortality rate, population with access to safe water, underweight children under age five, adult literacy rate, gross employment ratio for all levels, real gross domestic product per capita, daily calorie supply per capita, infant and maternal mortality rate, female student rate, and women in government.

When Canada was at the top of the Human Development Index (HDI) we did read more about this report.

The report also relied on measures such as the GDP and the GNP (Gross National Product), the means used by most countries to measure their economic progress.

But HDI report also introduced several interesting indices: GINI coefficient, a measure of inequality in the distribution of landholdings, the GDI, a gender-related development index and the GEM, a measure of gender empowerment. These measures seldom make the newspapers.

As workers around the world struggle to retain their plots of land and their way of life, surely the problems arising from the huge movement of landless people into mega cities of squalid poverty is newsworthy. It has yet to dawn on economists that living on $2 a day does not leave money for all the products our economy produces. When our customers have money we should be happy. When our potential customers are poor, business will suffer.

Another section of the HDI measured the Defence Expenditures as a percent of GDP, and per capita and as a percent of combined education and health expenditure, as well as the total armed forces and import of conventional weapons. This trend is most dramatic in the United States today as expenditure for war and military activities dwarfs the amount spent on health, education and social programs. In Canada we are told there is not enough money to improve our healthcare or education systems or to lift our children out of poverty yet we have plenty for the war in Afghanistan.

War benefits the stock market. The rumor that President Vladimir Putin may return to power as prime minister of Russia caused a rise in the RTS index. Business wants and needs stability and autocratic leadership often seems to give that. There is another way in which war benefits business beyond the military equipment producers. Dick Cheney and Donald Rumsfeld have built personal fortunes on the activities related to war. That their jobs as advisors to both Bush regimes put them in a position to urge the waging of war is overlooked by most analysts.

Could Women Do Better?

The empowerment of women and the resort to war are related as Dr. Mary-Wynne Ashford notes in her book *Enough Blood Shed*. "There is always a gender gap on matters of war and defense. You'll find women less willing to go to war, less willing to spend on defense, and more attuned to health-care needs, educational needs, and childcare needs" (Zogby International pollsters).

Our global war system is dominated by men. "Masculinity has always been an essential tool wielded in this many-pronged process of empire-building. At home it has been necessary to convince both men and women that a militarized manliness (especially one allied with a manly sort of reason and a manly brand of commercial competitiveness) was a superior form of humanity." Women are rising in power in governments but are, as yet, too few to change our policies.

Many of our worst problems are caused by male thinking: more and faster cars, more nuclear power plants, more ingenious military devices, information gathering by resort to torture in secret sites, carpet bombing as a foreign policy and an international financial system that is dysfunctional. How can it be thought that women could not do better?

Do wars have an impact on the price of gold? Wars destabilize societies and many affected people rely on gold, even on their jewelry, in a time of crisis. It maintains its value when local currencies collapse and can be redeemed at any time for cash. The price of gold may go down if there are more sellers than buyers. However as author Michael J. Kosares notes "This renewed interest in gold is not so much as a hedge against the devastation of war but against something much more subtle – the potential devastation of wealth from an international collapse of the dollar and a subsequent economic breakdown." The breakdown seems likely as the US trade deficit soars. In 2004 it was $665 billion and was covered by borrowing from foreigners at the rate of $2.6 billion every business day.

Have I joined the gold rush? Not yet even though I agree with the authors of *The Coming Collapse of the Dollar and How to Profit from It* that the US economy cannot sustain the high military spending, high level of debt and imbalance of trade for much longer.

Many writers have referred to gold.

It was Thomas Gray who wrote: "Not all that tempts your wandering eyes and heedless hearts is lawful prize, nor all that glistens gold."

An old proverb says, "Gold and love affairs are hard to hide."

But, as usual, George Bernard Shaw has durable advice, "You have to choose, as a voter, between trusting to the national stability of gold and the natural stability and intelligence of governments. I advise you, as long as the capitalist system lasts, to vote for gold."

Shirley Farlinger

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Enron's Ghost Walks the Battlements

Perish the thought that COMER should have sucked that one out of its thumb!

In its issue of 16/10 ("Fund Aims to Avert Banking Crisis" by Carrick Mollenkamp, Deborah Solomon, and Craig Carmin), *The Wall Street Journal* tracks the connection between the problems of off-book accountancy that the Enron trials and enquiries were to have solved and their conservation to serve our gaming financiers.

"The bailout plan supposed to revitalize credit markets and prevent some major banks from straining their balance sheets raises two crucial questions: Why didn't investors see the problems coming? And how could they have happened in the first place?

"Changes enacted after Enron Corp's collapse were supposed to prevent companies from burying risks in off-balance-sheet vehicles. One lesson of Enron was that the idea that companies could make profits without taking any risk proved as ridiculous as it sounds. Regulators made a great show of slamming closed that loophole, but as the current situation makes clear, they not only didn't close it all the way, but the new rules in some respects made it even harder for investors to figure out what was going on.

"That is causing headaches in banks, especially the biggest institutions such as Citigroup, Bank of America, and J.P. Morgan Chase. All these along with assistance from the Treasury Department, joined to craft the rescue package for what are known as structured Investment vehicles or SIVs.

"These SIVs, along with vehicles called conduits, don't get recorded on banks' books because regulators and accounting-rule makers gave banks a pass when crafting post-Enron changes meant to curtail off-balance-sheet activity.

"All the banks had to do was structure the vehicles so that the risk of loss associated with them was ostensibly transferred to other parties. Then the bank vehicles could stay off the bank balance-sheet. That allowed banks to make bigger profits without having to tie up capital on their balance sheet. Never mind that the banks created, ran and garnered fees from the vehicles.

"Yet the fallout of some of these vehicles shows that banks, and their shareholders, did shoulder a lot of the risk connected with some of these vehicles and essentially controlled them. This belies the fiction of "separateness" as allowed by accountancy rules,' said Christopher Whalen, managing director of Institutional Risk Analytics, a Los Angeles research and risk management systems firm."

The Enron Disease Lives On

"This is the Enron disease. We have not killed it. Enron structured transactions to be within the letter, if not the spirit, of accounting rules in a bid to keep the deals off its books and out of the view of its investors. No one is saying, of course, that the banks are literally shams like Enron.

"A spokesman for the Financial Accounting Standards Board, which drafted the current rules, declined to comment.

"Banks use SIVs and conduits to issue short-dated commercial paper and medium-term notes, investing the proceeds in assets such as credit-card debt and mortgage securities. The vehicles profit by capturing the difference or spread, between the notes they sell and their investments. The sponsoring banks then garner these profits in the form of fees they charge for the vehicles.

"The lack of disclosure to investors about

Big Banks Flock to "Notes" to Cash In on ETF Boom

Key distinctions on financial markets are becoming so subtle that investors will soon be needing seeing-eye dogs to lead them around on their trips to Wall Street.

The Wall Street Journal (2/11, "Big Banks Flock to 'Notes', to Cash in on ETF Boom" by Shefall Anand) reports: Several big banks including units of Deutsche Bank AG and J.P. Morgan Chase & Co., are planning to launch exchange-traded notes, a type of debt security marketed as being similar to to exchange-traded bonds. Both ETFs and ETNs typically track an index and trade on a stock market throughout the day.

"For investment banks, ETNs are shaping up as an easy way to repackage and sell investment products, known as 'structured notes,' which previously were offered only to wealthy clients or to big institutional investors. Two weeks ago Barclays PLO launched eight commodity-oriented ETNs under the 1Path brand, bringing its total to 16.

"Also last month Deutsche Bank entered the fray with a note 'ETN' under the Elements brand, which promises the return of a stock index managed by research firm Morningstar Inc. In May, Goldman Sachs Group launched a note backing an enhanced commodity index, and in July Bear Stearns & Cos. launched an ETN tracking an index of master limited partnerships.

"'ETNs are going to explode in popularity,' says Christopher Yeagley, head of Global Investment Solutions America at Deutsche Bank. 'From an investor's standpoint, it looks, feels and smells similar to ETFs.'

"For investors, ETNs are a tool to access certain investments such as commodities and currencies, which aren't widely available in the fund format. However, they have significant differences from their ETF cousins. For instance, ETNs don't have to adhere to some of the regulations that apply to ETFs and regular mutual funds.

"In addition, fund-industry trade-group Investment Company Institute is pressing for an examination of the advantages that ETNs are marketed as having.

"The ICI says it is preparing to send a formal letter to the House of Representatives Ways and Means Committee. which has oversight over taxation issues, arguing that tax laws inappropriately treat ETNs and ETFs differently, and arguing that this situation 'should be fixed.'

"A key structural difference between the two: ETFs hold a basket of securities like stocks and bonds, and a share in the ETF represents a portion of those assets. An ETN, by contrast, isn't backed by a specific pool of assets. Rather, it represents a promise by its issuer to match the returns of, say, a particular index or commodity (minus fees).

"As a result, ETN investors must pay attention to the credit rating of the issuer. If an ETN issuer went bust, investors would have to wait in line like other debt holders." ETF investors, on the other hand, would have a claim on their portion of the asset reserve set aside for investors in the ETF.

"That can make a tremendous difference."

W.K.

SIVs and conduits, along with the risks they pose, is 'significant enough that getting a real feel for what the potential impact could be is difficult,' said Craig Emrick, senior accounting analyst with Moody's Corp.

"Citigroup, for example, has nearly $160 billion in SIVs and conduits, but its shareholders wouldn't get a clear view of this from reading the bank's balance sheet Instead, footnotes only disclose that the bank provides 'liquidity facilities' in conduits that had, as of June 30, $77 billion in assets and liabilities.

"'Generally, the company has no ownership interest in the conduits,' the bank's second-quarter filing, the latest available, states. The Citigroup filing makes no mention of SIVs. In a letter to investors in August, Citigroup disclosed that it had about $100 billion in SIV assets, although that has since declined to about $80 billion.

"A Citigroup spokeswoman declined to comment.

"Banks typically agree to acquire the assets of their affiliated conduits if they can't roll over their IOUs. But they only backstop a portion of SIV assets Some have had to step in, but backstops aren't a sign of ownership under accountancy rules. In fact, in the traditional sense, off-balance-sheet vehicles, including SIVs and conduits, don't have 'owners.' Rather, they are like corporate zombies, and are typically set up in offshore tax havens.

"Because of this, the accounting rulemakers trying to clamp down on off-balance-sheet vehicles decided to look at who shares in the risks and rewards of a structure rather than who owns it, when assessing control. But banks found that they could structure vehicles so that other parties would have to shoulder losses. That allowed them to pass the risks test and keep the vehicles' current rules. Although the recent debt market turmoil and its effect on these vehicles have concerned accounting standard-setters, there is no plan at the moment to reconsider."

The banks, gorged with the powers that deregulation and globalization have given them, are well on the way to bringing down not only their own solvency, but society itself. For as ultimate resort there always remains the military option at once puts all everything on and off the balance sheet.

W.K.

RENEW TODAY!
(SEE PAGE 2)

Zarlenga and His Discovery of 100% Money

It would seem that Stephen Zarlenga, has settled the problems of banking by declaring fractional reserve banking "immoral," not to be discussed at the meetings of his American Monetary Institute. That apparently leaves him with enough time on his hands to put together the "real" story of my relationships with John Hotson, about which he knows nothing. However, Zarlenga invents as he goes along. Thus Mr. Zarlenga does not hesitate to write: "Just a short note to let you know that the AMI (American Monetary Institute) has an outstanding 47-minute DVD presentation of the later Prof. John Hotson. It is the talk he gave in New Zealand in 1991, and is even more timely now. He sounds like the American Monetary Institute, citing some of the same and facts that we do. When some reason when this was showed at the Bromsgrove meeting, Bill Krehm asked why I went to so much trouble to find that video (Ken Bohnsack owns it and had it in a closet), when he had hundreds of articles by Hotson. I asked him whether they were on line? It was a rhetorical question – we know that Hotson does not get much attention on their website, after an Internet search to find the year Prof. Hotson died. We are going to make the Hotson video (DVD) on our website and would like to charge $20 when delivered to defray costs."

It so happens that I have no part in choosing the contents of the COMER website. That is the job of John Riddell who has his hands full of putting current selections from our monthly print publication on the internet. From our website what he chooses get reproduced in Britain in print by a small doughty publication *Sustainable Economics*, the newsletter of the Green Economy Working Group, that often publishes a selection of articles from our next issue even before they appear in Canada.

Zarlenga Belatedly Discovers Hotson

On the other hand Mr. Zarlenga has never shown the slightest interest, nor allowed us more than 20 minutes of time at AMI Conference 1, that I devoted partly to introducing the work not only of John Hotson, but of *FOMC Alert*, a non-profit information devoted entirely to monitoring the US Federal Reserve System and making its findings available without cost. It is true that Zarlenga did announce what was described as the likely presence at his first AMI Conference of William Greider. Greider is associated with *FOMC Alert*, and thus an advocate of confining the banks in the Federal Reserve system to fractional-reserve banking; that is, to banking under the Roosevelt Banking Law reform. Greider whose writing opened a new epoch in monetary reform in the US, did not show at the AMI conference. Since he and *FOMC Alert* are advocates of fractional reserve banking, they presumably would have not been allowed to speak because Mr. Zarlenga cannot abide immorality as defined by himself. Greider had paid his tribute to Hotson's work while he was still alive.

Spinning Old Wives Tales

Before Mr. Zarlenga goes on spinning mischievous old wives' tales about my relationship with Hotson, he should become acquainted with Hotson's own writings on the subject. Thus my first book *Price in a Mixed Economy – Our Record of Disaster*, that appeared in 1970 long before COMER came into existence, was dedicated to Hotson: "To John Hotson, a beacon of open-mindedness in the ranks of the dismal science." And in his Foreword to it John wrote: "Krehm, a deep and independent student of economic theory and events, looks beneath surface phenomena such as budget balance and the rate of money growth to seek the causes of our economic malaise. Specifically, he sees the relative and absolute growth of the public sector, so characteristic of modern life, as exerting a potent and persistent tax-expenditure-interest-push. Krehm's term for this impact is 'Social Lien.' He maintains that economists have missed the significance of this structural change because they are mesmerized with marginalism and monetarism. Many of his coinages such as 'social lien, social revalorization, aggregate shift function,' etc., are useful and I think destined to enter our vocabulary."

That first book of mine has an interesting story, which in itself underlines the unusual valour of Hotson. In the long run he put his university career at risk in having been beyond all the organizational chief of COMER. COMER held its conferences at

Waterloo University. John organized entire groups including businessmen to accompany us on delegations to present our views to the central bank and to the Commons finance Committee. John Hotson died in January 1996 while being operated on for a heart defect. Inevitably, the legend arose that it had been a planned death, but I have heard nothing to remotely substantiate such a view. What is undeniable, however, is that it broke his heart being pushed out of the teaching post that to which he had dedicated his whole existence and his immense organizational and other talents. No financial settlement could compensate John for being separated from his beloved teaching post.

That first book of mine also highlights the valor needed for Hotson to proceed with his organization of COMER. The Depression of the thirties had ended my university course after two years of maths and physics, though I continued pursuing that introduction to the proper use of mathematics that was to serve me well in my private economic studies. I had worked as a staff correspondent for *TIME* in Latin America when dictatorships dear to Washington had begun crumbling. The cold war put an end to that and with my severance pay I started building houses in Canada on my return and earned enough to make me capable of writing what I wanted and from my observation of the combination of public services and private investment that house building, I formed some unorthodox views on what might be inflationary, properly redefined, and what could simply reflect the increasingly mixed nature of our economy. However, treating all government spending as current spending befuddles the picture and the one year write-off of investments by the government in physical and human capital creates budgetary deficits that are not necessarily there.

A Bad Situation Made Worse

At the same time the debt incurred by using the central bank less and less for financing such capital investments of the governments makes a bad situation worse, and the phasing out of the statutory reserves in 1991-3 left the benchmark interest rate set by the central bank the sole means of guiding the economy. That was tantamount to putting power in the hands of finance capital. The effective role of money creation from non-interest-bearing debt spent into existence by the government to interest-bearing money loaned into existence by the banks. The resulting manuscript went to some thirty economic magazines throughout the world. The leading French economic magazine, *La Revue Économique*, published the sixty-page article and even paid me $100 for it.

Only later did I understand why. Several French writers had noted that market supply and demand could not explain the price index rise and were searching for an "unidentified factor." My "social lien" filled that bill. No sooner had the article appeared in print than I received a letter from a leading French publisher – Kalmann-Levy asking whether I would write a book elaborating the theme of my article further. I spent the next year doing so and the result was my first book. But the world had undergone a great change in the intervening years. Only heroes like Hotson would not submit to that. Any independence from the self-balancing market theory was out. The book published by myself received a very favourable review in the Cambridge *Journal* and in France and in a Finnish publication.

Meanwhile John continued attending conferences of every sort of democratic reformist organizations And almost invariably brought home to COMER some like-minded rebel. Bill Hixson was one such. As was the late Lynn Turgeon, economic professor at Hofstra University, on Long Island, a prolific thinker and writer who advised his graduating students not to take graduate economic courses because they would mess up their minds, Harvey Wilmeth of the University of Wisconsin who called my attention to the fact that the tax-paid government services, which I had recognized as a non-market-determined factor in price, turns up not once but twice and thus to the second degree – once in the cost of the privately created goods that the government buys to provide its own services, and then in the value-added by the government itself. I had no difficulty in working out the mathematics to prove this rigorously, and many other relationships that equilibrium theory simply ignores as "externalities."

Countless were the conferences organized by others that Hotson and I attended together. Usually I did more than my share of the speaking, but Hotson was always there to advise me not to forget to mention that I represented COMER and of course, he often spoke himself. Never, ever, was there the slightest rivalry about who should take the floor on COMER's behalf. This happened at the Sorbonne in Paris, in some of the major cities of the US Eastern coast at the Eastern Economic Association's conferences, where we, indeed, had our own sessions.

These are precious memories to me. But for Zarlenga nothing is sacred. He is in there sniffing for scandal. The first volume of *Meltdown*, published in 1999, is headed "The John Hotson Memorial Series." That contained almost four hundred pages of the best of the first decade of *Economic Reform*. Within two months Volume two under the same dedication, and volumes 3 and 4 should be out within a year. All will bear the same dedication to the memory of John Hotson. His widow, during the years that she survived John, not only attended COMER conferences, but sent us a generous monetary contribution each year. Her way of keeping the memory of John green.

If Zarlenga had shown the slightest interest in what Hotson had to say, there was a book that Hotson wrote himself. It is entitled *Bastard Keynesianism*, and there is no espousal of 100% money in it. In the New Zealand DVD to which Zarlenga attaches such importance, after referring to Milton Friedman and other later monetarist economists who advocated 100% money – thus surrendering the advantage of the *Bank of Canada Act* that is still if completely disregarded on the books, Hotson in New Zealand goes on to say that he would not go so far as to espouse 100% money. That is hardly an espousal of 100% money. However, in all our relationship during which I published four long instalments of review of Zarlenga's book – I would have come to the 100% money bit and taken firm but polite issue with it. However, Zarlenga, who seems to have awarded himself a patent on the field of monetary theory on moral grounds, felt that I was giving his book away. Instalment Five would have disillusioned him on the point.

Meanwhile Zarlenga cast a pall over the Bromsgrove Conference. Even local proponents of 100% money know how to respect the rights of those who disagree with them, but only Zarlenga could have organized a chorus of a half dozen or so to boo my explanation how 100% month money would confirm the false claim of the banks to be mere intermediaries lending out strictly what they take in. And assigning the distribution of private credit to government employees, would multiply political corruption. Surely there is enough corruption in Chicago politics without that supplement.

William Krehm

Some Revealing Correspondence

The following correspondence bears on the issue of whether monetary policy is important when analyzing major social problems such as resources exhaustion, technological "progress," poverty, health and medical care, structural breakdown, etc. Author of the comments is Gunnar Tomasson, an independent scholar in the DC area who served a lengthy term as a senior IMF staff member and who challenged one of the chief gurus of economics (Paul Samuelson) early in his career, on the subject of money's neutrality. One of Tomasson's specialties is the logic and methodology of science and its application to economic and social issues. The series begins with a letter he wrote to a journalist and also published in a place where it came to my attention and prompted a comment, which appears below in the letter to Ignatius.

Keith Wilde

April 8, 2006

Dear Mr. Ignatius:

I read with interest your column in yesterday's *Washington Post* – "A Vital Task for the IMF" – in which you pick up the thread from your column of January 6, 2004, on which I commented briefly at the time. "This perpetual motion machine," you wrote of the large deficits being incurred by the US and the large surpluses being accumulated by China and Japan, "can't continue forever."

"A starting point for thinking about these global financial issues," your column states, "is a speech given Feb. 20 by [Bank of England Governor] Mervyn King [who] argued that the IMF today is an institution without a clear mission. "If not in deep slumber, then the Fund has appeared drowsy. It is an institution, it is said, which has lost its way."

Governor King's words convey the idea that the IMF is something other than an institution whose primary agenda is set forth in the IMF's Articles of Agreement agreed by its members, and whose execution is supervised by the IMF's Executive Board on a continuous basis in-between periodic policy-making meetings of the IMF's Board of Governors, including the Governor for the UK.

In my view, as long-time [1966-1989] former senior member of the Fund staff, the "deep slumber" of the IMF's policy-makers set in thirty years ago, when other IMF members failed to respond in principled fashion to the scuttling of the Bretton Woods System by the Nixon Administration – an act which triggered the subsequent structural disintegration of the world financial system.

At the time, the scuttling of the Bretton Woods System was welcomed by leading mainstream and monetarist economists, including Paul A. Samuelson and Milton Friedman – economists, who had not so much lost their way as never having found it in the first place. With the IMF being at the cross-roads between academia and the real world, IMF policy-makers took their cue from them.

In Samuelson's vision, the world financial system is "a largely self-regulating system," as you put it – a vision, whose theoretical underpinnings he set forth in *Foundations of Economic Analysis* in the 1940s.* It may seem far-fetched but, as attested to by Stanley Fischer in a farewell address at the IMF, the Washington Consensus is built on Samuelson's Foundations.

"Now," you conclude, "is the time for the Bush administration to help create a new IMF that can repair the international structure before the hurricane hits." Absent reconsideration of monetary first principles, it is certain to be one "heck of a job" – for the Washington Consensus cannot in principle be challenged on logical grounds, given its underlying methodological presuppositions.

As before, I am cc.-ing this message to my Gang8 colleagues (www.creditary-economics.org).

Sincerely,

Gunnar Tómasson

* In this study I attempt to show that there do exist meaningful theorems in diverse fields of economic affairs. They are not deduced from thin air or from a priori propositions of universal truth and vacuous applicability. They proceed almost wholly from two types of very general hypotheses. The first is that the conditions of equilibrium are equivalent to the maximization (minimization) of some magnitude.

[The second is] the hypothesis…that the [economic] system is in "stable" equilibrium or motion." (Foundations, p. 5)

April 8, 2006

Dear Gunnar,

Re your Gang8 post on this subject: Thanks for a very tidy assessment of the situation and especially for the reminder about Samuelson and the presumption in his Foundations that the system tends to equilibrium regardless of monetary management. It helps to reduce my indignation when economist colleagues insist that monetary magnitudes and financial institutions are neutral and devoid of useful consideration for the problems they bemoan as intractable.

Keith Wilde

My note elicited the following confirmatory information and clarification:

Dear Keith,

In the late 1970s, I wrote to Samuelson that his "stability" hypothesis – "an a priori proposition of universal truth and vacuous applicability" – was *logically* incompatible with the fact that modern money creation does not require use of scarce physical resources.

A fact which implies that modern money is effectively a *free good*.

Samuelson wrote back with a *non sequitur* comment to the effect that "if" governments were to act "as if" money were a free good, "then" there might ensue "temporary" departures from the conditions of equilibrium.

That's "temporary" as in the 30-year departure occasioned by US domestic credit creation!

Gunnar

The above was followed almost immediately by an additional comment:

Re: the following:

A fact which implies that modern money is effectively a *free good*.

Clarification:

The "laws" of Supply and Demand which underlie Samuelson's "stability" hypothesis do *not* apply to "free goods."

A point whose validity mainstream scholars acknowledge in round-about fashion by insisting that "money doesn't matter."

Or so they did for a long time – then, when that position became untenable, Samuelson covered all his bases as follows:

"Economics is not an exact science. We cannot repeat the 1970s under controlled conditions to settle the debate ["Monetarism versus the eclectic majority"]. Therefore an author should present in his book a framework of analysis that can be shaded in favor of either of these two scientifically proposed models. This text has been written to make this possible. The most important consideration is that Friedman's

researches have joined with the researches of post-Keynesians, such as Yale's James Tobin and MIT's Franco Modigliani, to insist that *money does matter very much,* to work out the *channels by which it works*, and to deny the view that some Keynesian followers took after 1939 (and which still prevailed in Britain's 1959 Radcliffe Report) that money does not matter much or at all" (*Economics*, Tenth Edition, 1976, pp. 331-332).

So Keith, when your "economic colleagues" insist that "money doesn't matter," they are *out of the mainstream* and stuck in a Keynesian 1939 time warp!

Gunnar

P.S. Note the opening statement: "Economics is not an exact science."

Of course, that's *not* the point at issue – the one that Samuelson has *known* to be intellectually fraudulent at least since our correspondence in the late 1970s. G.

Correspondence

BoC Ownership

A letter to Grant Baudais, October 31, 2007

Connie Fogal asked me to write to you about ownership of the Bank of Canada. She credits me with more credentials on the subject than I deserve, but I am glad to share what information I have.

When I first reviewed the correspondence to you from Robert Turnbull, Assistant General Counsel for the Bank of Canada, I was surprised to see his statement that the "Bank is not a public corporation," and realized that this would cause confusion with those who equate "public corporation" with "government corporation." Then he followed with the statement that "All of its shares are held by the Government of Canada." So I wrote to Mr. Turnbull and asked, "Would it be correct to say, for clarification, that what you are saying here is that because the Bank's shares are not traded publicly it is by definition "not a public corporation," even though the Bank refers to itself as a public institution?"

Mr. Turnbull replied, "I think your proposed characterization hits the nail right on the head. The Bank is not a public corporation as that term is usually understood: a corporation that issues shares to the public. However, it clearly is a public institution, in that it is established by federal statute for the express purpose of serving certain purposes for the good of Canadians."

Grant, you have clearly identified that the shares of the Bank are held by the Minister on behalf of the Queen. There is no question about that, and Mr. Turnbull clearly identifies the Bank as a public institution established by statute so there is no question about that.

You also say that ownership of the Bank of Canada is not the primary issue, the real question being, is the Bank doing the job it was mandated to do as described in the preamble to the *Bank of Canada Act?* The clear answer, as you say, is "No," and "we should focus having the Bank of Canada do its proper job."

I want to thank you for raising this issue because it has led to clarification which will help if and when we are confronted by others who may raise questions of a similar nature.

Good luck in your work with CAP.

Richard Priestman
Kingston Chapter, COMER

Negligent Use of the Federal Surplus

To COMER members:

The letter below was sent to the following newspapers on October 28: Toronto Star, Star Electronic Publishing, Ottawa Citizen, Kingston Whig Standard, Independent Voice (Kingston), Kingston Eyeopener, Vancouver Sun, The Scoop (Windsor), Windsor Star.

Please feel free to send a copy or modified copy over your own name to other papers. And, if you haven't already done so, don't forget to look at bankslovedebt.com on YouTube and tell students to do so too.

Richard

The Editor:

David Miller, Mayor of Toronto, is outraged over the federal government's nearly $14 billion debt payment, and other city mayors should be, too. This money could have and should have been used to repair some of the damage inflicted on Medicare, education (especially post secondary), housing programs and infrastructure such as roads, bridges, water lines, sewers and water treatment facilities. Municipalities are almost swamped with downloads and property taxes are rising.

Using the money to pay down the national debt is negligence of the most serious nature. We have a public bank, the Bank of Canada, which can carry federal debt at almost no cost. It could have assumed $14 billion of the debt leaving the $14 billion surplus for other uses. All the parties in the House are aware of this, but none of the current crop wants to talk about it – and neither, it seems, do journalists.

Both Liberal and Conservative finance ministers' responses to using the Bank of Canada to finance public debt is that that would cause inflation, completely ignoring our history. From 1939 to 1974, the government used the Bank to finance a significant portion of public debt. In 1950 the inflation rate was 2.8; in 1971 it was 2.9; then it began to rise as a result of the big increase in the cost of oil. One of the tools used to contain inflation was the statutory reserves. These were removed by Brian Mulroney in 1991 and would have to be re-instated to keep inflation under control. For example, chartered banks and other financial institutions could be required (collectively) to put $14 billion in reserve so that the $14 billion put into circulation by the Bank would be off-set by the funds put in reserve.

While you and I cannot get an interest-free loan from a bank or other commercial lender, the government of Canada can when it borrows from the Bank of Canada because it owns the Bank. Any interest charged to the government by the Bank comes back to it as dividend less a small cost for administration. Amazingly, our government chooses to borrow commercially rather than from its own bank with the result that we pay in our federal taxes about $32 billion a year in unnecessary interest. More than that, with the co-operation of the federal government, provincial and local governments could also borrow from the Bank of Canada at very low cost, but this does not happen. Provincial and local governments, collectively, pay about $30 billion a year in interest for a total of over $60 billion a year paid by Canadian taxpayers in unnecessary interest.

We used the Bank of Canada before to finance public capital projects and we can do it again. It is a matter of political will, and this is a good time, politically, to act on this. Politicians are more inclined to listen to proposals from their constituents when faced with an election.

Richard Priestman
Kingston Chapter, COMER

The Statistics of Financial Growth Elbow Out Those of Human Survival

The subprime mortgage shakeout in the US is crossing oceans as though with super-daddy longlegs, giving rise to some second thoughts where doubts have rarely lurked. *The Globe and Mail* (23/10, "IMF gives warning of greenback's fall" by Barrie MacKenna) assembles some of these: "Washington – International Fund Chief Rodrigo de Rato has done what the Group of Seven would not: issue a dire warning about the economic fallout of the faltering greenback.

"A much weaker US dollar which touched a new low against the euro yesterday could inflict damage on other countries, said the Spaniard, who is in his final week as IMF managing director."

That in itself is a novelty. The IMF was engendered at Bretton Woods to reflect the interests and whims of the US. Even economists of the prestige of John Maynard Keynes – heading the British delegation – had to bite their tongues and let the IMF, which they had conceived as a means of reconciling the interests of creditor and debtor nations, be set up as a creature of Wall Street to whip the debtor nations – those of unrepayable debts and hopelessly flagging currencies – into line. And now a retiring Spanish head of that organization speaks his mind about the growing US international debt and the drooping dollar!

Mr. Rato used no euphemisms: "A much weaker US dollar, which briefly touched a new low against the euro yesterday, could inflict damage on other countries, including much of Europe, said Rato. 'There are risks that that an abrupt fall in the dollar could either be triggered by, or itself trigger, a loss of confidence in dollar assets,' Mr. Rato told the IMF's Board of Governors.

"Mr. Rato raised the spectre of a protectionists backlash in Europe if the slide isn't halted soon.

"'There is a risk that exchange rate appreciation in countries with flexible exchange rates – including the euro area – could hurt their growth prospects, and in these circumstances protectionist pressures could worsen,' he said on the final day of the annual meetings of the IMF and the World Bank."

That is a degree of threat and frankness that no power at the founding Bretton Woods Conference dared utter, or for decades thereafter. By its own abuse of the role, Washington has compromised as never before its role as lone superpower.

"Over the weekend, US Treasury Secretary Henry Paulson stymied European efforts to address the weak dollar in a joint statement from the G7 leading industrialized nations." And here the IMF, of all places, had become a pulpit for pouring out the contempt and resentment that American financial policies have inspired!

On the other hand, the communiqué called on China to speed up the appreciation of the yuan – the only currency named specifically. The finance ministers and central bankers from the US, Japan, Germany, Britain Canada, France and Italy, also agreed to keep a close eye on exchange markets and to "co-operate as appropriate."

"For his part Mr. Paulson reiterated the US mantra that 'a strong dollar is in our nation's interests,' adding that the currencies should be set by free markets.

"In his speech, Mr. de Rato did not mention the Canadian dollar, which has appreciated much more rapidly against the US dollar than the euro in recent months.

"On Sunday, Bank of Canada Governor David Dodge argued that the latest spike in the loonie was 'abnormally' fast and not justified by economic fundamentals. The Canadian currency hit parity with the greenback Sept. 20 for the first time since 1976.

"The loonie and the euro both retreated against the US dollar yesterday. The Canadian dollar fell to $1.02 (US), down $1.55 cents from Friday's Bank of Canada close. The fall was attributed to weaker commodity prices. The loonie is up 1918% against the US dollar so far this year, and 65% since 2002, when it slipped below 62 cents. It is also up substantially against the euro and the yen, making life tough for exporters.

"Mr. de Rato is slated to leave office November 1, two years before the end of his contract. He'll be succeeded by Dominique Strauss-Kahn, a former French finance minister.

"Former US Federal Reserve Board Chairman Alan Greenspan also expressed concern over the weekend about the dollar's slide, saying there's growing aversion among foreigners to buy US securities. 'Obviously there's a limit to the extent that obligation of foreigners can reach,' Mr. Greenspan said in a speech in Washington. 'Central banks and private funds have been turning to [other] currencies including the euro.'

"Total holdings of US equities, notes and bonds fell a net $69.3 billions in August, after an increase of $19.2 billion in July."

China's Plethora of Cheap Dollars Is Leading to Some Basement Bargain Shopping on Wall Street

In the column adjoining the above article, *The Globe and Mail* offers us an article on China's sensational progress in entering the financial scene of world high finance: "CITIC's Bear Stake puts China in middle Wall St." by Marcus Gee: "The latest sign of the tidal shift came yesterday when China's CTC Securities Co. bought a one billion dollar (US) stake in the famous old US investment firm, Bear Stearns Cos. The deal, the biggest investment for by a Chinese securities firm, would give the state-controlled Chinese company a presence on the main thoroughfare of Western capitalism.

"Under the proposed deal, CITIC and Bear Stearns would invest about one billion in each other and form a joint venture based in Hong Kong. The deal highlighted the reach and sophistication of Chinese institutions. Once saddled with bad loans and derided as shaky wards of the state, Chinese banks and brokerages have made a series overseas investments like China Development Bank's purchase of a stake in Britain's storied Barclays Bank in July.

"CITIC seems eager to follow, founded only in 1995, and listed on the Shanghai stock exchange in 2003, it has seen its stock price rise tenfold in the past two years as it profited from underwriting new share offerings on the red--hot Chinese market. CITIC is part of the CITIC Group, a giant conglomerate established in 1979 by China's 'red capitalist,' vice-president Rong Yiren, to become a funnel for Western investments in China as it opened to the outside world.

"Now CITIC is funnelling Chinese riches abroad. Chinese leaders are encouraging CITIC and other Chinese outfits to look overseas for better returns.

"Last week another lending financial

firm, Industrial & Commercial Bank of China, accelerated it own overseas expansion by announcing it would be setting up branches in Moscow, New York and other global cities. ICBC is now the biggest bank in the world by market value, at more than $330 billion.

"For Bear Stearns the CITIC deal brings an injection of much-needed funds. The 84-year-old firm was hurt this summer by the troubles in the US subprime mortgage industry.

"On top of the banks' rising wealth, China commands $1.4 trillion in foreign exchange reserves. Some of that money, traditionally invested in safe vehicles like US Treasury bonds, is starting to flow abroad too. China set up a special fund last month to invest the money more aggressively."

The Irreplaceable Function of the Statutory Reserves

Not least of China's ability to come to the aid of the stressed US banking system is a detail passed over in silence by the reports in Western publications. Much of its financial strategy was actually developed in the US under Roosevelt to cope with the Depression of the 1930s. It used to be explained in all textbooks published up to 1991. But since 1991 it has become one of the great unmentionables, as the banks have essentially taken over our economies. These were the statutory reserves that required the banks to redeposit with the central banks a proportion of the deposits they received from the public. These reserves, that earned no interest, served a double purpose. They made available to the government a seigniorage – the use of money that cost it nothing in return for it surrendering to the banks the modern version of the ancestral monarch's monopoly of coining – and more important – recoining them with less precious metal content. That has in its modern version become the banks' ability to create near-money (i.e., interest-bearing loans created as a growing multiple of the legal tender that they have in their vaults or hold with the central bank).

These statutory reserves provided the central banks with an alternative or a supplement to their use of the benchmark interest rate to attempt to lick "inflation." The trouble with the effort to keep prices flat with higher interest rates is that can achieve that goal only by placing the economy at the mercy of the financial sector, in particular encouraging speculative gambles. Higher interest rates also attract foreign money and that pushes up the value of the currency, and discourages sales at home and abroad.

The Chinese government continues to make use of statutory reserve to prevent its currency, the yuan from rising, and cutting off its exports. Much of China's exports can be traced to its low currency. It is the device of statutory reserves, developed in the United States, but essentially abandoned by it to endow interest rates – the primary revenue of the financial sector – with a near-monopoly position.

This severe handicap in any eventual contest with the Chinese, could well prove fateful. Without it, it is questionable that the Chinese could keep their currency low enough to amass to the positive balance of trade that is the key to their present emergence not only as an industrial giant, but as a major if not the dominant figure in world finance.

William Krehm

Snagging Some Attention in Kingston

The campaign of Kingston COMER affiliates to secure funding for municipal infrastructure and other public investments through Bank of Canada caught the attention recently of Andrew Ball, a business and economics journalist with Queen's University Student Radio, CFRC, at 101.9 FM. His comments on the proposal were heard by some COMER members who are among his regular listeners, and they alerted Richard Priestman, president of the local chapter. Richard initiated a correspondence with Mr. Ball, which led to an invitation to attend the next regular meeting of the group. Mr. Ball accepted, and brought his micro-recorder to 99 York Street on October 19. (His condensation of the discussion was broadcast on Wednesday, the 22nd.)

A Little Nervous Throat-clearing

The discussion was tentative and exploratory, for the group had not adopted a collectively prepared set of talking points in support of cryptic policy statements that Richard has managed to get into local press and public forums. (See past issues of *ER* for examples.) It therefore became an opportunity for a review of essential COMER precepts and policy prescriptions as perceived by the individuals in attendance. Initial expressions of concern that contradictory viewpoints might emerge under this format soon evaporated as individual contributions proved to be mutually reinforcing, with minimal digressions, and focused on the issue that had aroused Mr. Ball's interest. In this atmosphere, Andrew was a participant and responded to questions about the content of training programs for business students and of economics policy courses that he personally follows as an elective. An economics text currently favored in university programs was on the table, and reference was made to it in parts of the discussion.

It will be no surprise to readers of *ER* that discussion focused on the virtually universal reaction of business and economic policy commentators to the proposal that Bank of Canada be used more aggressively to finance public investment in obviously needed areas such as municipal infrastructure, health promotion and medical care, education, development of alternative energy sources and reduction of CO_2 emissions. That is, it would be inflationary.

There was all-around agreement that inflation is a difficult concept to pin down, and especially to calculate accurately. It was noted that business news from radio and TV regularly presents it as simply an increase in some price index or other. Furthermore, the explanation offered frequently alludes to some factor such as crop failures in Florida or oil pipeline explosions in a war zone. These factors constitute a *real* increase in cost of production. Higher prices are not necessarily *inflated* prices, in other words, for they can reflect higher costs. The traditional, indeed the essential, meaning of inflated prices is that they are blown up by the non-real villain of monetary instruments that can't hold their value. This failure is normally attributed to excessive growth in the quantity of money. To quote the economics text: "When a government creates large quantities of the nation's money, the value of the money falls." More generally, any excessive increase in M(oney supply) can cause an increase in P(rice level) unless the Q(uantity – including quality) of goods produced grows also. This happened famously to Spain with the gold it brought back from the New World. And even more famously to Germany in the 1920s.

Attention then turned to the role that legislated powers of the Bank of Canada should

be playing in the financing of municipal and other public-interest investments. Mr. Ball had expressed concern that this would inevitably entail an increase in money supply. He had circumspectly stopped short (in a letter to Mr. Priestman) of saying that this would be inflationary, however. And indeed it need not be. Many volumes of argument and historical experience can be cited to demonstrate that an increase in money supply may facilitate a commensurate or even greater increase in real production. Putting it the other way round, an inadequate supply of money and/or credit can be a serious constraint to production and exchange. A critical consideration is the time horizon that is built into a deliberate increase in money supply. Investments in education, transportation networks, water and sanitation conveyances, scientific research and technology development, health maintenance, resources sustainability, etc., make a society more productive and prosperous, but it may take some time to reap the full reward. The kind of increase in M that is required for these purposes is more accurately conceived of as *credit*. The German hyperinflation was the consequence of printing ever greater quantities of *currency* in an effort to command a quantity of goods that was not increasing. The government in that case was competing as a *consumer*. The COMER proposal, by contrast, is for government to expand the supply of credit to *invest* for longer term, more permanent prosperity.

The Advantage of Owning a Bank

When government invests for purposes such as those mentioned above, it must do so on credit, for current tax revenues are sufficient for little more than regular operational requirements. The costs of borrowing (interest payments) become an operating expense and are added to the government's annual operating budget. That is how Canada was developed, from the days of John A. Macdonald and the financing of the Pacific Railway, for example. And from the late 1930s until the 1970s, the Bank of Canada was used to finance wars and megaprojects without inflation or runaway debt. An important reason for that benign effect is that the Bank is wholly owned by the Government of Canada. That means that annual interest payments on government borrowings for investment in development projects, which are revenue to the Bank, are mostly returned as profits to the sole shareholder. In other words, investments in important public infrastructure can be, and have been, virtually interest free. Hence, the question that affiliates of COMER are putting to their political representatives around the country is "why aren't we using the same means now, when our needs are obviously pressing?" ("If we own the bank, why aren't we using it?")

The answer that "it would be inflationary" is highly suspect. If true, why was it not the case prior to the 1970s? What has changed? To predict inflation implies that the proposed investments would not be productive (of an increase to Q in the equation MV=PQ). And it suggests that the real issue is how aggregate national resources should be allocated. That is, for what purposes (and in what relative quantities) should our men and materials be used, in the concrete, material sense. Even more critical are the issues of who should get to make those decisions and reap the benefits.

Allocation before Distribution

As already noted, well-designed and executed investments in public utilities make individuals and enterprises more productive in the future. (Private developers in the Alberta oil sands understand that they will not succeed for the longer term unless Fort McMurray becomes more comfortable for the rapid influx of workers.) If men, machines and materials are already being used to full capacity, then a rational allocation calls for a rank ordering of projects and selection of the most important ones first. Because there is no benign dictator at the top to make these decisions, there is competition for resources among proponents of the various projects and a bidding war for men and materials may ensue. Projects with the promise of most immediate and highest returns are those most likely to win. In the short term, therefore, competition for resources might cause some activities to be postponed in anticipation of lower relative prices after the current burst of investment projects starts bearing fruit. These conditions might look like inflation, but they are also the circumstances of real growth in the nation's productive capacity. They therefore offer the opportunity for a general increase in welfare.

Closer examination of the inflation bogey suggests that it is a convenient smokescreen used by a few powerful members of society against the interests of the great majority. In other words, the issue is distributive justice as well as resource allocation. Even under conditions of full employment, a truly sovereign government could out-bid private investors if public investments were of highest priority. At this point detractors appeal to the massive government debt and its burdensome carrying cost to taxpayers. The response of COMER, of course, is that this debt was unnecessary and can be eliminated through effective use of the Bank of Canada. As Mr. Ball noted, the debt is conventionally attributed to "the high spending days of Trudeau, Mulroney, and a couple of wild minority governments." The origins of the debt and the beneficiaries of the interest on it that is paid by taxpayers expose the distributive issue. The question of origins, as well as why Bank of Canada financing of development projects was not inflationary in the past, and of what happened to change the situation, requires a search into the past. As a few of the pertinent details were put forward and discussed, Mr. Ball noted that his course work in economics and finance has emphasized mechanical expertise and abstract principles in contrast to an historical approach. (This is probably a general situation in university programs and merits investigation by COMER members.)

History, for Empiricism over Assumptions

Time did not permit a detailed exposition of the changes to banking (non) regulation over the past three decades that led to the present situation (as chronicled in *ER* and other documents and books), but some important consequences were noted. Partly as a response to pressure by the banks in the face of major losses on their investment ventures in the seventies and eighties, the federal government gradually transferred most of its borrowing to the private market. When BoC sells government bonds, it depresses their price, raising interest rates. Government guaranteed returns were a plum that capital pools could not resist, even though it meant competition for private investment projects. The consequence was a sharp spike in interest rates, a "favor the saver" policy that produced a budget deficit as government interest costs shot up, forcing even more borrowing and a consequent ballooning of government debt. That was the "spending program" that got the government into trouble. It transferred billions of taxpayer dollars to private investors via record-high interest rates. That is how the debt was created and how paying the interest on it continues to dwarf all other federal budget items today. In this situation, tax revenues reward private investors. That might be acceptable if there were some distributive equity in ownership of the

debt. And there would be if more of it were owned by Bank of Canada.

It was acknowledged that there is a fairly widespread opinion that governments ought not build and operate enterprises, period. (Many COMER members might agree with this when it leads to giving away going concerns to friends of the government!) Proponents of this view have some serious arguments on their side. It is supported by critical analyses of bureaucratic organizations that are operated (ineffectively or perversely) by governments and funded by tax revenues. On the other hand, there are some social functions that seem ineluctably public in nature, and there are ample grounds for believing that they are under-funded at this time. This is a political issue, however, and to dismiss the COMER proposal for use of the Bank of Canada as inflationary disguises the political preference by suggesting that opposition is based on "economic science."

In connection with the possibility that government-funded projects might overheat the economy, it was pointed out that legislated powers of the Bank of Canada give it the option of restraining credit expansion by private banks. It can impose or change reserve requirements. Banks were once limited to lending no more than ten times the amount of deposits they held. Removal of this limitation was one of the changes that has occurred since the early '70s. This topic led to two interesting observations:

- The economics textbook says that the reserve requirement was suspended in order to "give banks a level playing field." They complained that they were not being treated fairly by having to maintain reserves with Bank of Canada when other credit-granting institutions were not so constrained.
- Mr. Ball manifested some surprise at this, because he was under the impression that the reserve requirement is still in place.

The foregoing is particularly significant because the textbook on the table was one that Mr. Ball recognized as the one he had studied from in Economics 101. Since Andrew also told us that he has taken subsequent courses in economics and finance, it strongly suggests that intermediate and senior level courses fall back on traditional concepts of money mechanics. As he also told us, the courses he has taken focus on abstract principles and pay little attention to history.

Keith Wilde

(George Biro, Don Findlay, Richard Priestman and Peter Zuuring made written contributions to the preparation of this report.)

New Fund to Prevent Bank Crisis

"The nation's biggest banks are attempting to woo investors and other banks to a mega-fund that will buy troubled assets by promising not to purchase the riskiest securities and forcing sellers to pay a fee to put their assets in the fund. (*The Wall Street Journal*, 13/10, "US Investors Face an Age of Murky Pricing" by Susan Pulliam, Randall Smith and Michael Siconolfi)

"Many investors welcomed the plan by Citigroup Inc., J.P. Morgan to set up the $100 billion fund. They expressed hopes that the plan, announced yesterday, as expected, by the banks, would help jump-start the commercial paper market, which provides financing for things including mortgages and big investment projects but has been struggling since last July. The fund would issue short-term notes to investors and use the proceeds to buy securities from specialized funds, known as 'structured investment vehicles, or SIVs, that are being forced to wind down their businesses.

"In doing so, the fund would help prevent the SIVs' asset sales from triggering a market meltdown. There are some 30 SIVs with about $400 billion in assets.

"'There's a lot of details to be worked out...but they're talking the right language,' says Joseph Benevento, head of cash management at Deutsche Bank Asset Management. To entice investors, the fund will place hefty demands on participating SIVs, requiring them to help insure investors against losses and accept a discount on assets they sell to the fund. The fund will avoid all but the most highly-rated assets, signaling to investors that it won't be tainted by subprime mortgage problems.

"The plan was designed by Citigroup and backed by the US Treasury where worried officials had been monitoring the turmoil in credit markets. Treasury also heard proposals or ideas from other banks including Lehman Brothers Holdings Inc. while Germany's Deutsche Bank AG, a big fixed-income operator in the US, also offered ideas, said people familiar with the situation.

"Treasury officials portrayed their role in helping banks from big losses on mortgage securities as an appropriate short-term response to concerns about tightening liquidity in the capital markets. They also suggested regulatory changes that might be needed to prevent future problems.

"In his first public comments on the plan, Treasury Secretary Henry Paulson said the huge bank-affiliated funds that were kept off-balance-sheet and that owned assets backed by shaky mortgages and other securities suffered from a lack of transparency and that regulators may need to step in to avoid future problems. 'The regulators didn't have enough visibility about what was going on with these off-balance-sheet SIVs.'"

The Danger of a Dumping of Dubious Bank Assets

"In the short-term Treasury officials said the financial markets were in danger of a large-scale dumping of assets by the banks, which would have hurt capital markets and potentially spilled over to the broader economy. To avoid that, Treasury stepped in to facilitate discussions among the banks for a private-sector solution, which culminated in the creation of a fund to buy SIV assets.

"Some have criticized the Treasury for essentially helping the big banks avoid the financial pain associated with the risky bets that didn't pan out. The reaction in Washington, however, was more muted. Democrats sought to use the Treasury's willingness to get involved to bolster their demands that the Bush administration do more to help homeowners who are also suffering from the subprime downturn.

"The leading banks associated with the initiative sketched the broad outlines of the fund, which could be operational by mid-December and will be called the MasterLiquidity Enhanced Conduit or M-LC. It would serve as buyer of the last resort in troubled credit markets – particularly for markets backed by mortgages and other assts.

"Citigroup, which is the largest sponsor of SIVs with seven such affiliates, has been criticized on the grounds that its own SIVs would benefit most from the plan.

"According to people familiar with the plan, though, the price for admission for SIVs will be high. SIVs will be allowed to sell only rated AA or better and likely will be unable to sell collateralized debt obligations – pools of debt repackaged into slices with different levels of risk and return. In addition, the SIVs will have to pay a fee to the super conduit and accept a hefty discount in the price of the securities they are selling.

Continued on page 19

Dark Ages America: The Final Phase of Empire

This is far too important a work to fit within a single review. We shall therefore deal with the various aspects of contemporary America and its influences on the rest of the world, in shorter takes. The role of the "frontier" in American history is the first that we shall examine since that has essentially been the American way of approaching economic problems – by simply "going West" and eventually appropriating new lands into its domains, pushing aside the detail that those lands may already have been occupied. Or to quote Berman…

"The West Versus the Rest"

"One of the most insightful approaches to this topic is that of the eminent historian Charles Beard, whose work was subsequently enlarged by William Appleman Williams *(The Tragedy of American Diplomacy).* For Beard, foreign policy was really an afterthought; it grew out of domestic policy, which was essentially about money. The centerpiece of the foreign policy strategy of William McKinley, Theodore Roosevelt, William Howard Taft, Woodrow Wilson, and Warren G. Harding, he argued, was economic expansion – exporting our economic surpluses.

"This, in turn, meant pushing open the doors of trade and investment everywhere, whether by polite coercion, or by military force. It was only by trade and investment, these presidents believed, that the United States could flourish, and the permanence of its domestic order could be assured.

"But how far back does this pattern go? According to Williams, Americans thought of themselves as an empire in terms of the American continent (that is, from Revolutionary days). Alexander Hamilton, for example, referred to the United States as such in *The Federalist*. James Madison wrote Thomas Jefferson in 1786, 'Most of our political evils can be traced to our commercial ones,' and he proposed as a guide to policy and action, the same kind of argument that historian Jackson Turner did a century later in his famous 'frontier thesis,' which explains our prosperity as a result of (westward) expansion. Beginning with the presidency of Andrew Jackson (1829-37). In particular, democracy was seen as intertwined individualism, private property, and a capitalist market economy, but the process of territorial expansion had already begun under Jefferson with the Louisiana Purchase of 1803. Indeed, during McKinley's war on the Philippines, Senator Albert Beveridge, defended the president's actions by saying that McKinley was merely walking the path marked out by Jefferson. (The Louisiana Purchase – roughly half a billion acres at less than 3 cents a pop – has rightly been called 'the greatest land grab in all history'). Natural greatness, liberty, and territorial expansion early morphed into a unified whole, the ideology of which was labeled 'Manifest Destiny.' Thus Turner wrote that expansion had been the dominant fact of American life for three centuries, and that the frontier was absolutely crucial to American history. What it provided, he said, was a 'gate of escape' from existing responsibilities, and it sustained a pattern of relying on external factors for solutions to internal problems....

"To take one of the most egregious examples, issues of imperialism were clearly present during the Mexican War under President James Polk, who was trying to subject the predominantly foreign population of California, New Mexico, and possibly of all Mexico to American rule…. The immediate cause of the war was the annexation of Texas in December 1845, along with the American desire to acquire California. When Mexico rebuffed Polk's attempt to 'negotiate' these issues, the United States had no inhibition about shifting from diplomacy to force. By the Treaty of Guadalupe Hidalgo (2 February 1848) Mexico was forced to cede 40% of its territory when the US troops entered Mexico City.

"According to Williams, when America ran out of frontier and there was no more contiguous land to buy, annex, or conquer – the root impulse got channeled into overseas expansion. It was during the 1890s, when the US was beset by a severe economic crisis, that the nation recognized that the continental frontier was gone, that the nation formulated the argument that expansion into an economic and even territorial empire was the best way to maintain its own prosperity.... The famous Open Door notes of 1899-1900, written by McKinley's secretary of state, John Hay, advocated not colonialism but rather a policy of 'an open door through which America's preponderant economic strength could enter and dominate all underdeveloped areas of the world.' Nor did subsequent Democratic presidents (Jimmy Carter excepted) attempt to deviate from that, says Williams. It can accurately be described as a program of informal empire. As early as 1902, Princeton University President Woodrow Wilson wrote that overseas expansion was the economic frontier that would replace the American continent as the territorial frontier.

"What then is the 'tragedy of American diplomacy,' in William Appleman William's memorable phrase? Essentially, it's that we uphold an ideal of self-determination for the peoples of the world, which we then subvert by defining our foreign policy as a process of helping other people solve their problems by three ideas. Essentially, we uphold an ideal of self-determination for the peoples of the world, which we then subvert by defining our foreign policy as a process of helping those peoples become...like us! We don't grasp that this is an oxymoron. We don't see that in expanding our own economic system, the well-being of which we have since McKinley tied to overseas expansion – we make it difficult for others to retain their economic independence.... The upshot was the liberal state extended the practice of colonialism: local peoples ruled, but within limits defined by their economic ties to the imperial power.

"President Harding continued that program, urging Americans to go on to the peaceful commercial conquest of the world. Rather than being a revolution, it was a way of preventing one: even in the depths of the Depression, overseas expansion of the American corporate state was regarded as a basic means of economic recovery.

"Nobody could have foreseen this, of course, but it was the Open Door policy that set us on the long road to the Age of Terror, in which we now find ourselves through foreign eyes, to see those who object to being steam-rolled by us as anything but knaves or ingrates has a very long history.

"William Appleman Williams was the first and perhaps the greatest of the so-called revisionist historians, and he left behind him a distinguished discipleship who expanded his insights in various ways. Many

of Williams' latter-day disciples would agree – the economic emphasis is too narrow. Williams never really demonstrated the concrete link between the economy and the concern of policy makers, and as early as 1966 conceded that the idea of the Open Door might have drifted away from its economic moorings. Historian J.A. Thompson, in a critical review of Williams' work published in 1873, points out that for the most part, American exports have been usually lower than 5 percent of the GDP, and the bulk of our trade is with other advanced, not with the Third World. But Americans, says Thompson, have often discussed their foreign policy in terms of national security, prestige, racism, and religion as well, and these have sometimes been autonomous from economic issues. The argument would seem to function best when if it does not exclude other factors."

However, the absence of access to markets and even the control of those that exist, are still economic problems. Before Americans took to spilling across their frontiers into much of the rest of the continent, their trade with the regions beyond the existing frontiers had similarly been negligible, but what drew Americans to go west, were still economic goals in the broadest sense of the word.

"It turns out that ideological factors were also present. Thus Michael Hunt defines ideology as a structure of meaning that is part of the culture – so much so that we take it for granted and are not really aware of it, and regard other ideologies as aberrant. The ideology underlying American foreign policy, he goes on, is coherent, emotionally charged, and comprised of three interlocking ideas. all of which emerged by the early twentieth century, and which together constitute a 'civic religion.' The first sees the American future in terms of a quest for national greatness, coupled to the possession of liberty. The second defines attitudes toward others in terms of a racial hierarchy. The third holds that with the exception of the American Revolution, revolution in general is a potentially dangerous thing.

"By 1900, expansionists argued that we would remake others in our own image, for the benefit both of them and us. Is it purely coincidental that most of our imperial ventures or wars of... conquest from Mexico in 1846 to Iraq in 2003, involved an 'enemy' who was non-white? Our newspaper cartoons depicted blacks as brutes or children, Asians as inscrutable or somnolent. Motion pictures portrayed Latinos as greasers, Latinas as sultry, and Arabs as devious, fanatical, or evil. All of this has a long history. In effect, racial hierarchy permeates our culture and has been used to underwrite our claims to foreign lands and to justify the imposition of Anglo values and institutions. 'Our relationship with the Middle East is the culmination of a foreign-policy that has been building for some time and will prove to be, I believe, the linchpin of the American downfall.'"

In our next issue we will present and discuss further sections of this remarkable book.

W.K.

"The United States of Subprime"

The headline of the front-page article in *The Wall Street Journal* (11/10, written by Rick Brooks and Constance Michell Ford) would have no difficulty qualifying for what the Germans call *Galgenhumor* – "hangman's wit." "As America's mortgage markets began unravelling this year, economist seeking explanations pointed to 'subprime' mortgages issued to low-income minority and urban borrowers. But an analysis of more than 130 home million home loans made over the past decade reveals that risky mortgages were made in nearly every corner of the nation, from small towns in the middle of nowhere to inner cities in affluent suburbs.

"The analysis of loan data by *The Wall Street Journal* indicates that from 2004 to 2006, when conventional lending slowed and subprime lending accelerated, more than 2,500 banks, thrifts, credit unions and mortgage companies made a combined $15 trillion in high-interest-rate loans. Most subprime loans, which are extended to borrowers with sketchy credit, fall into this basket.

"High-rate mortgages accounted for 29% of the total number of home loans originated last year, up from 16% last year, and 16% in 2004. About 10.3 million high rate loans were made in the past three years, out of a total of 43.6 million mortgages. High-rate lending jumped by an even larger percentage in 68 metropolitan areas, from Lewiston, Maine, to Ocala, Florida, to Tacoma, Washington.

"The *Journal* analyzed more than 350 million records on mortgage applications and originations filed by lenders under the federal *Home Mortgage Disclosure Act*. Subprime mortgages were initially aimed at lower income consumers with spotty credit. But the data contradict the conventional wisdom that subprime borrowing are overwhelmingly low-income residents of inner cities. Although the concentration of high-rate loans is higher in poorer communities, the numbers show that high-rate lending also rose sharply in middle-class and wealthier communities.

"Banks and other mortgage lenders have long charged higher rates to borrowers considered high risk, either because of their credit histories or their small down payments. As home prices accelerated across the country over the past decade, affluent families turned to high-rate loans to buy expensive loans they could not have qualified for under conventional lending standards. High-rate loans are those that carry interest rates of three percentage points or more over US Treasurys of comparable durations.

"The *Journal's* findings show that the subprime aftermath is hurting a far broader array of Americans than many realize, cutting across differences in income, race, and geography. From investors hoping to strike it rich by speculating on condominiums to the working poor chasing the home-owning dream, subprime loans burrowed into the heart of the American banking system – and now are bringing deepening financial woe.

""We had an aggressive home mortgage industry trying to get people into homes they couldn't afford at a time when home prices were very high. It turned out to be a house of cards, 'says Karl Case, an economic professor at Wellesley College. We're in the early stages of the clean-up."

The Subprime Mortgage Blight is not Confined to the Needy Home Buyer

"The *Journal's* analysis indicates that some major subprime lenders, such as Washington Mutual Inc.'s Long Beach Mortgage unit, began scaling back or tightening their standards a year or more ago. But commercial banks and thrifts filled the void, helping to sustain real-estate markets that might otherwise have begun cooling. Many loans at risk of going bad have not yet done so. As much as $600 billion of adjustable rate subprime loans, for example, are due to adjust to higher rates by the end of 2008, which means that more and more borrowers are likely to fall behind.

"Fort Myers, FL, is famous for its beautiful boulevard lined with palm trees,

bankrolled years ago by its most famous snowbird, inventor Thomas Edison. These days, the city is fast earning a reputation as an example of the deepening US mortgage crisis. The area's median sales price for existing homes is down 22% since December 2005. Foreclosures are running at an all-time high. And there is no end in sight.

"The *Journal* compared the fastest-growing loan markets to the rankings of home foreclosure filings compiled by data providers Realty Trac Inc. and Foreclosures. com. In Stockton, CA, for example, high-rate loans accounted for 33% of total home-loan volume last year. up from 13% in 2004. During the first half of this year, the Stockton area had 8,169 foreclosure filings, or one for every 27 households. According to Reality Trac that makes Stockton the nation's foreclosure capital.

"Seven of the 10 large metro areas now struggling with the highest foreclosure rates – including Miami, Detroit, and Las Vegas – now borrowers barrel into high rate loans much faster than the country as a whole.

"In a forthcoming study in the *Journal of the American Planning Association*, Daniel Immergluck, an associate professor at Georgia Institute of Technology in Atlanta, found a similar pattern between foreclosures in the early 2006 and cities with high subprime lending in 2003.

"Lenders did little to discourage speculation in real estate investors, which contributed to rising home prices. Last year, 13% of all high-rate home loans were for properties not occupied by owners, up from 9% in 2004. Experts say such properties are higher foreclosure risks than homes occupied by their owners. Who will be left holding the bag for mortgages that go sour? Wall Street bought lots of subprime loans and packaged them for sale to investors. The data show that lenders shifted even more of their riskiest loans to investors as the boom began to fizzles."

And of course, the grouping of the supposed risks into different swaths, when in fact there was little of the risk management that was being claimed and paid for, heightened the aspect of sheer scam. It was in fact the exact equivalent of the speculative trading that was going on commodity tock markets, in which poker games were being played without actual gas, oil, gold, or whatever changing hands. This pushed up prices, of course, while more and more of it amounted to a poker game, in which each card bore the marking a million barrels of oil, without a barrel of real oil changing hands.

W.K.

Bogus Pricing on Wall Street in this Information Age

Wall Street is becoming living proof of a simple fact: you cannot have spreading technologies of crooked trading without bringing into question the price quotations of stock markets where such trading is done. Here is what *The Wall Street Journal* (12/10, "US Investors Face an Age of Murky Pricing" by Stuart Pulliam, Randall Smith and Michael Sinolfi) has to say on the point: "Since the invention of the ticker-tape 140 years ago, America has been able to boast of having the world's most transparent fiscal markets. The tape and its electronic descendants ensured clear prices for stocks and many other securities were readily available to everyone, encouraging millions to entrust their money to the markets.

"These days, after a decade of frantic growth in mortgage-backed securities and other complex investments traded off exchanges, that clarity is gone. Large parts of American financial markets have become a hall of mirrors.

"The hazards of this new age of uncertainty became clear at Dillon Read in March, when rising defaults by homeowners were hammering the value of mortgage securities. John Niblo, a hedge-fund manager at the firm, acted fast. He twice slashed his fund's valuation of securities tied to 'subprime' mortgages, knocking them down by about 20%, or nearly $100 million, say traders familiar with the matter.

"But managers at UBS AG, Dillon Read's parent company, were irate. The Swiss banking giant was carrying similar securities on its books at a far higher price, the traders say. In conference calls, the UBS managers grilled Mr. Niblo on his move. 'I'm marking to where I could reasonably sell them,' Mr. Niblo responded during one call, according to the traders familiar with the conversations.

"UBS later shut down the house hedge fund, and Mr. Niblo was let go in August. Last week, UBS announced a $3.7 billion write-down in $23 billion of securities with mortgage exposure including securities from the shut-down fund. Such pricing problems have become common in some of Wall Street's biggest markets. The burgeoning universe of complex securities based on mortgages and other assets has turned the simple task of getting a price quote into a confounding undertaking.

"Today, 'way less than half' of all securities trade on exchanges with really suitable price information, according to Goldman Sachs Group Inc. analyst Daniel Harris More and more securities are priced by dealers who don't publish quotes."

When Buyers and Sellers Must Grope in the Dark for Fair Prices

"As a result money managers can no longer gauge with certainty the value of assets in some mutual funds, hedge funds and other investment vehicles – a process known as 'marking to the market.' An official at the Securities and Exchange Commission said recently that some bond mutual funds might be using outdated prices to value their portfolios.

"The growing uncertainty over what assets are really worth could wreak havoc on the efforts of both individuals and money managers to invest rationally during this summer's confusion over bond valuations. For example, it was especially difficult to know whether to buy or sell. Investors forced to fly blind sometimes resort to panic selling, which can produce wild swings on the markets.

"Billionaire investor Warren Buffett advocates more transparency in pricing. 'Some marks can be pretty imaginative,' he says 'They call it "marking to market, but it is really marking to myth.'

"For years, one of the bedrocks of US financial markets had been that clear prices were available to all. When prices went up or down, investors knew it right away and they could usually figure out why. The credit crunch that struck earlier this year highlights a danger lurking in markets for newfangled securities. When buyers pull back and nothing trades, investors can be in for unpleasant surprises. During this summer's credit crunch, more than 80% of investors in bonds tied to the mortgage market said they had trouble obtaining price quotes from their bond dealers, according to a survey of 251 institutional investors by Greenwich Associates, a Connecticut consulting firm.

"Over the years non-exchange-traded investments have produced plenty of pain for investors. Some go-go mutual funds

dabbled disastrously in illiquid investments in the later 1960s and early 1970s; a 1994 meltdown in the mortgage-securities market toppled Wall St. titan Kidder Peabody; and hedge fund Long-Term Capital Management collapsed in 1998 after bad bets on opaque bond markets.

"But investing in securities difficult to price is far more wide-spread today. Between 2000 and the end of last year, the market value of bonds outstanding, most of which don't trade on exchanges with readily available prices, rose 75% to $25.2 trillion, according to Citigroup Inc. That's more than triple the 23% growth rate over that period of the Dow-Jones Wilshire 5000 index, which tracks all listed stock. The stocks in that index carried a $17.7 trillion market value at year end."

The financial sector has grown disproportionately, taking over control of the industrial and other sectors to fully appreciate that the above statistics from Wall Street sources make up a disastrous dirge for our deregulated and globalized economy as a whole.

And indeed *The Wall Street Journal* (27/10, "CDO Ratings Are Whacked by Moody's" by Aparajita Sara-Rubna and Carrick Mollenkamp) fills in a few further blank spaces: "Just days after Merrill Lynch & Co. rocked the markets with a $8.4 billion write-down tied mainly to mortgage-related investment holdings, Moody's Investors Services Inc. commenced a fresh series of credit-rating down-grades of similar instruments. The ratings firm cut, or said it was likely to cut, ratings on scores of collateralized debt obligations, or CDOs, which are financial instruments often tied to mortgage-backed securities. Some of these CDOs were cut from the highest possible AAA ratings to junk, an especially noteworthy step."

It literally places a question mark over credibility of the globalized and deregulated world banking sector to which the control of the world economy has been entrusted.

"The subprime mortgage market has seen soaring delinquencies after years of aggressive bank lending. Lending became especially lax in 2006 and early 2007 even though housing had already shown signs of peaking, Subprime mortgages were the collateral in all of these investments.

"Moody's downgrades or a notice that the debt might be downgraded are sure to bring new heat to the rating services themselves. Many critics have argued that Moody's, McGraw-Hill Cos., unit Standard & Poor's, and other ratings and other ratings services [were too high] in their initial ratings of these investments, and then too slow to downgrade them once the housing market declined. When investors see a bond go from AAA to junk in just over six months, the rating agency's credibility suffers.

"Moody's didn't total the dollar volume or number of CDOs that were downgraded or put on review for possible downgrade. An initial count put the number in the billions. On 11/10 Moody's downgraded thousands of subprime mortgage-backed securities created in 2006, which were originally worth $33.4 billion. At that time Moody's said 502 CDOs had direct exposure to those subprime bonds.

"CDOs are complex structured financial products. They bundle debt and then issue new securities with differing amounts of risk and return. They are and have been at the heart of broader concerns in recent months."

What the *WSJ* is telling us that with the entire contents of many CDOs turning out to be of junk quality, there was no serious basis for charging investors premium prices for dearer swaths for supposed lesser investor risk. In short Wall Street were charging for and delivering bags of doughnuts with nothing inside the paper bags. Is that not a matter for criminal law to concern itself with?

The High Cost of Repressing Freedom of Thinking in Our Economics University Faculties

But doesn't this implicate the entire mythology of the self-balancing market? And since our universities have been swept clean of the teachings of just about every one of the great economists who questioned the creed of the "self-balancing market" and its supposed wisdom, and of the history of the banking reforms under Roosevelt that disallowed our banks from acquiring interests in the other "financial pillars," to wit stock markets, insurance and mortgage firms. Should not then economics departments of our universities come under examination for their responsibility for the damage done to society that is just beginning to surface?

I may be allowed to become even more specific. Derivatives – rates of growth of ever higher degree – feature in the mystique that confuses one of the many tools of mathematical investigation with, somehow, scientific investigation *per se*. It is true that it was infinitesimal calculus that allowed Newton to discover the law of gravity. But he did not deduce gravity *from* calculus, but from the astronomical observations of Tycho Braho and others from which Kepler had established the closed orbits of the planets around the sun.

However, to take the use of calculus as a guarantee of scientific investigation, is to confuse what mathematics and scientific investigation are about. Newton deduced the law of gravity from Kepler's astronomical observations with the help of calculus. And to attempt to deduce anything about the economy from calculus, rather than with the help of calculus if it should prove helpful in analyzing an economic problem, would be like a physician x-raying the x-ray machine, while leaving the patient in the waiting room to pick up the bill for the treatment.

Undoubtedly in the concoctions proven so sensationally irrelevant, derivatives will have played a role, as they did in the so-called Nobel awards to two of the economists who set up the Long-Term Capital Management that provided the disaster of the year in 1998. Undoubtedly derivatives served to give subprime mortgages the glitter of pseudo-science in the current disaster. Derivatives are the ideal technical tool for painting the utter misleading pictures of a world prospering on ever-accelerating growth of the speculative financial sector. In a proper post-mortem of the mistake – if we are ever to have one – there will have to be an analysis of the role of derivatives. And for that mathematical economists are worse than useless. For that long-delayed task mathematicians will have to be brought in from other faculties with a better understanding of what mathematics are about.

William Krehm

Crisis *continued from page 15*

In return for that discount, the SIVs will receive what is termed a 'junior' stake in the conduit – which will take the first hit if losses are incurred.

"Many fixed-income managers are intrigued by the idea of inventing a 'super SIV' fund. But some also say they are wary of the complexity of the proposed fund. And though the banks have indicated that they will avoid subprime loans, 'It's so murky,' says Jeffery Grundlach, chief investment officer for Los Angeles-based asset-management firm TCW Group, which recently launched a $1.6 billion distressed asset fund."

Complexity does make for murkiness and that doesn't let much light enter where much additional light is needed.

William Krehm

On Germany's Consolidations, Past and Present

Germany has had more than its share of unifications, much later than France or Britain. In the course of them it has fought wars with great adjacent powers, and was called upon to sharpen its political skills to keep the nobility in the saddle even while at times conciliating the middle and working class forces.

Accordingly Otto von Bismark, as head of the Prussian Government served his Hohenzollern monarchs by a series of subtle compromises with the middle class democrats and the Socialist workers, whom at other moments he imprisoned. The rapidly rising industrialists he won over with tariff protection, and originated such anomalies as health insurance as early as 1883, compulsory accident insurance in 1884, and even old age pensions.

This amazing background contrasts unflatteringly with the current state of social services in Germany. At this point let us bring in the front-page article of *The Wall Street Journal* ("New Trend in Germany: Food Handouts for the Poor" by Marcus Walker): "Wuppertal, Germany – Men with shoulders hunched against the rain line up at the back of a van, where volunteers dole out bowls of stew and chunks of bread. Once served, the men take shelter under shop awnings to eat. Few speak.

"The scene could date from the Great Depression, but it takes place every evening in this bustling industrial city in Western Germany. Like others sipping their soup, Hans Martin says he comes here for a simple reason: 'Hartz 1.' That is the 2005 welfare law that slashed benefits for Germans who have been out of work for over a year. Mr. Martin, a 54-year-old warehouse worker with heart trouble and numerous missing teeth, says he can't find work. His monthly benefit checks cover him for only about 20 days, he says. Towards the end of each month, he comes to the soup van to avoid going to bed hungry. 'I'm lucky. I don't drink,' he says. Others do, and they run out of money on day 10.

"For decades. Germany's state kept the majority of people out of poverty. Even the unemployed could often live comfortably. The state paid them benefits over half their last salary, indefinitely. Unemployed Germans were often better off than the lowest paid workers in the US.

"Today, as in many other European countries, Germany's welfare state is in retreat. Europe's stuttering economic performance during the past decade has led governments to trim benefits and rein in public spending, hoping to push people who have become dependent on welfare back to work. To some, especially those without higher education, that means low-paid work or none at all.

"Germany gained poor residents when it attached the ex-Communist East in 1990. But poverty is rising fast in the country's more economically developed West, too. In 1999, 11% of the Western German population lived under the poverty line defined as less than 60% of median household income. In 2005 that rose to 16%, according to the German Institute of Economic Research."

Unification with the Ex-Communist East Germany Still Weighs Heavily

"In all of Germany around 14 million people, or 17% of the population, live beyond the poverty line, which today corresponds to a monthly income of about $1,280 for a person living alone. Such poverty is far less acute than the destitution found in slums of developing countries or even in some US cities. In contrast to millions of poor Americans, all Germans have health insurance.

"'Yet for Germans, the growing split in society is a jarring break with the postwar decades. Then a 'social market economy' spread affluence widely by combining industrial growth with a strong welfare state. Today blue-collar workers are falling out of the broad middle class,' says Berthold Vogel of the Hamburg Institute for Social Research. 'I fell a long way,' says Mr. Martin, stirring his vegetable and sausage soup with a plastic spoon After working for more than 20 years at a machine-tool component maker, he was laid off in a company restructuring in 1996. 'I had never been unemployed in my life,' he says. For a while he was while he was homeless. He now has an apartment, but his health is poor. His benefits have sunk to the new Hartz 1V flat rate of about $300 a month, plus an allowance for rent and heating.

"The economic upturn of the last two years has cut Germany's overall unemployment rate. But it has largely by-passed the low-skilled and the long-term jobless. The tasks they used to do have moved to low-cost countries.

"'There just isn't work for everyone any more,' says Wolfgang Nielsen, the volunteer head of the Wuppertal Table.

"Before volunteers set up food distribution centers – known as the 'table movement' in Germany – the poor didn't starve, but often fell into debt. Mr. Nielsen says, 'What people save on food thank to us, they can use to pay off their rent and other arrears, or to get their electricity switched back on.' When the former 57-year-old former insurance salesman set up the Wuppertal Table in 1995, it was one of the first in Germany. The idea of handing out surplus groceries had crossed the Atlantic from New York when social workers saw City Harvest food charity.

"Today Europe's biggest economy has 700 towns have 'tables' or volunteer groups that collect food that supermarkets would otherwise throw away, and give it to the needy. The Wuppertal Table that runs the roving van as well as a canteen, a fresh food stall and even a medical service, and feeds more than 700 people a day.

"At first, Mr. Nielsen says, he struggled to persuade Wuppertal's businesses, citizens and politicians to support the idea. People were used to funding the welfare state with their taxes and didn't think extra charity was needed. A breakthrough came when car-maker Daimler AG made a gift of 100 Mercedes vans to the budding German table movement, paving the way for other corporation donations. The Table's 250-odd helpers are mostly volunteers. 'Tables are in. It's chic to be involved with them,' Mr. Nielsen says. He says he is not Mother Theresa and never planned to work long hours for free. 'It just worked out that way.'

"Every morning, supermarkets and bakeries let Mr. Nielse's volunteers carry off unwanted stock: greens, fruit, bread, meat and other inventory that's too near its sell-by date, has minor packaging flaws, or was just over-produced. The food is unloaded at a disused former printing shop that is now used as a food distributing center. Men and women, some with children wait in the drizzle for the 11 a.m. food distribution.

"Adults pay a token 50 Euro cents to enter the building and fill shopping bans. The fee is meant to reduce the stigma of receiving alms."

Over the wealthy land that cannot provide dignified work that was possible 120 years ago, hangs a cloud of shame.

W.K.