THE JOURNAL OF THE COMMITTEE ON MONETARY AND ECONOMIC REFORM

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$3.95 Vol. 20, No. 8 • AUGUST 2008

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Growing Strands of Iffiness Entangle the World's Bank Bailouts

The New York Times (23/07, "A Mortgage Rescue Strains Calculations" by David M. Herszenhorn) reports: "Washington – The proposed government rescue of the nation's two mortgage finance giants should appear on the federal budget as a $25 billion budget expense, the independent Congressional Budget Office said on Tuesday, but officials conceded that there was no way to really know what, if anything, a bailout may cost taxpayers.

"The budget office said the chances were better than even that a rescue would not be needed before the end of 2009 and would not cost any money. But the office also said that there was a 5% chance that the mortgage giants, Fannie Mae and Freddie Mac, could lose $100 billion.

"The budget office said that the $25 billion would not have to be offset with spending cuts or tax increases as would normally be required by 'pay-as-you-go' budget rules, and instead would be regarded as emergency spending and added to the national debt."

What the reporter fails to do is remind his readers that the national debt since 1971 when the United States went off the gold standard and took the world with it on that detail, the debt of the central government has been the only legal tender in the US, and to a considerable extent in the world. There are thus *qualitative* as well as *quantitative* dimensions to the uncertainties surrounding the two mortgage giants. We do not know how much subprime currency will be entering, and indeed *has already entered*, the legal tender of the US and the world.

"The budget office, while acknowledging that the $25 billion was, at least, a rough estimate, did not explain fully how it came up with the figure. The office said it analyzed the companies' financial statements and consulted with regulators, analysts, market participants and the companies themselves to estimate possible future losses and the amount of any future cash injection that might be needed from the Treasury.

"The full $25 billion cost would appear on the government's books in both fiscal years 2009 and 2010; the Treasury's authority to aid Fannie and Freddie would expire at the end of 2009, or one-fourth of the way into fiscal 2010.

"Senator Jim DeMint, Republican of South Carolina, said lawmakers were generally supportive of the overall rescue plan, but he added that he had doubts about the $25 billion estimate, 'Everyone knows it's just a wild guess.'"

In short a bit like the risk controls of diced and sliced subprime mortgage packages. But this time the shoddy game is with the legal tender of the US, and to an extent of the world.

"The House is expected to vote as soon as Wednesday on housing legislation that includes the proposed rescue plan. The housing bill would also raise the national deficit to $10.6 trillion, with a $800 billion increase." Under the Rooseveltian banking laws that eased the Depression, the amount of legal tender obtained by the statutory reserves that the banks had to deposit with the Federal Reserve on a non-interest basis provided an alternative to a supplement to

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Website: www.comer.org

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***Economic Reform* Subscription only:** One year, 12 monthly issues, in Canada CDN$30, Foreign US$35

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***ER* Back Issues:** CDN/US$4, includes postage; additional copies same issue, $2; additional issue same order, $3. Send requests for back issues to Herb Wiseman, 56 Robinson Street, Peterborough ON K9H 1E8.

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PRINTING AND DISTRIBUTION
Watt Solutions Inc., London
Printed in Canada on recycled paper.

A Foretaste of the New World Washington is Setting Up

I owe our readers a word of apology for the figure-laden report on how Washington is kidding itself that it is cleaning up the subprime economy that it has created. What is involved is one of the very largest US banks taking over the largest mortgaging organization. The reporter is Gretchen Morgenson, one of the very keenest *Times* reporters.

My quotations are from *New York Times* (08/06, "Countrywide's Buyer Isn't Blinking). "Six months ago the Bank of America announced its plans to take over Countrywide Financial. Many investors have doubted that the $4 billion deal for the hobbled mortgage lender would get done. Bank of America has been strangely silent about its plans for merging the two operations, with the exception of a cryptic regulatory filing last month warning that investors should not count on it assuming all of Countrywide's debt.

"But in a conference call on Monday with investors, Kenneth D. Lewis, the chief executive of the Bank of America, confirmed his commitment to the Countrywide buyout, which is expected to close by the end of September. When asked about the fact that home prices have plummeted and loan defaults have soared since the deal was announced with Mr. Lewis defending it as 'compelling, with a pretty nice upside. We don't have our heads in the sand.'

"Investing in distressed assets, of course, can be extremely profitable. But be nervous about the deal, analysts say. As the nation's largest mortgage lender, Countrywide, stands at the centre of the mortgage storm and is being buffeted by woeful financial results, but also by intense scrutiny from state and federal regulators. Bankruptcy judges have become vocal about what they consider dubious tactics taken by Countrywide against troubled borrowers.

"'It's a lot to ask Bank of America shareholders to stomach,' said Mike Larson, a real estate analyst at Weiss Research in Jupiter, Fla.

"Countrywide is not only one of the biggest lenders in California and Florida, states that have been hit hard by the housing crisis, he said. It also has a large portfolio of home equity lines of credit and an especially risky type of adjustable-rate mortgage known as the option ARM. 'It shows that the company is vulnerable to many geographies and loan types that are showing the worst performance,' said Mr. Larson. 'It raises a real question about the logic of the deal at current terms.'

"Those terms, struck on Jan. 11 call for an exchange of Countrywide stock for Bank of America shares worth $5.56 each at current price. Indicating the skepticism about the transaction, Countrywide's shares trade at a 13% discount to that price.

"David Dreman, chairman of Dreman Value Management, which oversees $15 billion in assets, is a Bank of America shareholder who said had never been happy with the Countrywide deal at current terms.

"On Thursday, the Federal Reserve signed off on the transaction. Yet Countrywide's ugly financial results of late show no sign of abating. In the last three quarters it has lost $2.5 billion, according to financial filings. In the first quarter of 2008, total nonperforming assets hit $6 billion almost five times that of the same period last year.

"Countrywide declined to comment for this article.

"The credit risk in its loan portfolio is immense, analysts say. At the end of the first quarter, Countrywide had $95 billion in loans held for investments on its books, many of them adjustable-rate mortgages written on properties in California, where prices are still falling. Some $34 billion of the loans held for investments are home equity lines of credit and second liens, riskier because they are more likely to generate losses when home values fall."

Portfolio Valued from Internal Model for Lack of Market

"Countryside also has $15.6 billion in mortgages and related securities it hopes to sell. Of these, $10.4 are so-called Level 2, and hard to value because the market for them is inactive. An additional $5.1 billion are valued on internal company models, not market prices.

"Because of the credit risk in Countrywide's books, Paul Miller, managing director at Friedman, Billings, Ramsey, estimates that it will cost Bank of America an additional $10 billion to $15 billion above the $4 billion purchase price when a final

accounting of losses is made.

"Countrywide's role in the US housing market is hard to overestimate. In addition to being No. 1 lender, it is the nation's largest loan services in the nation, administering $1.5 trillion in loans by other institutions as well as itself. The servicing and processing businesses provides years of enviable profitability, but now they, too, are vulnerable to earnings pressure. especially as delinquencies surge and regulators heighten the scrutiny of the company's practices.

"Before the days of record-setting defaults, mortgage-servicing was a low-cost enterprise, generally around 0.3 percent of the dollar amount of the loans administered each year. The value of these operations rose and fell based on interest rates. If rates fell, mortgage prepayments would increase and the value of the servicing portfolio would decline. Conversely, if rates rose, prepayments would slow and the servicing unit's value would rise.

"But because the servicing business is built for payment processing, default significantly increase its costs. For example, companies administering mortgages must advance monthly payments to the owners of the loan even if borrowers stop paying. While each loan is different, these advances are typically made for at least three months.

"'As a result Countrywide's servicing portfolio is not worth what it once was,' said Thomas A. Lawler, founder of Lawler Economic and Housing Consulting. 'All of a sudden you've got to factor in a lot of variables that you didn't have to before.'

"Foreclosures also take longer to complete. The big increase in foreclosures – some 243,000 homes were in some stage of the process in April, according to RealtyTrac, up 65% from April 2007 – has gummed up the system. Foreclosures are likely to keep rising; the delinquency rate grew to 6.35 percent in the first quarter, the highest since 1979 according to the Mortgage Bankers Association.

"Countrywide's servicing unit lost $817 million before taxes in the first quarter, versus as $100 million loss in the same period of 2007.

"Countrywide's role in the US housing market is hard to overestimate. In addition to being the No. 1 lender, is the largest loan servicer in the nation, administering $1.5 trillion in loans made by other institutions.

Gasoline Prices Leave No Money to Maintain the Roads to Drive On

It is of the nature not only of economics, but of most things that everything sooner or later interrelates. There are no black holes left where economic and social problems can cower in isolation or end up manipulated to serve a favoured group.

This is being taught our governments once again in a way emphatic enough to warrant the ringing of church bells, and calling out the militia. We quote from *The Wall Street Journal* (28/07, "Americans Cut Back Driving, Straining Highway Funding" by Christopher Conkey): "An unprecedented cutback in driving is slashing the funds available to rebuild the nation's aging highway system and expand mass-transit options, underscoring the economic impact of high gasoline prices. The resulting financial strain is touching off a political battle over government priorities in the new era of expensive oil.

"A report to be released Monday by the Transportation Department shows that over the past seven months, Americans have slashed their driving by more than 40 billion miles. Because of high gasoline prices, they drove 3.7% fewer miles in May than they did a year earlier, the report says, more than double the 1.8% drop seen in April.

"The cutback furthers many US policy goals, such as reducing oil consumption and curbing emissions. But, coupled with a rapid shift away from gas-guzzling vehicles, it also means consumers are paying less in federal fuel taxes, which go mostly to helping finance highway and mass-transit systems. As a result, many such projects may have to be pared down or eliminated.

"The challenge comes at a time when surging costs for asphalt and other construction materials already are straining state and local transportation budgets. These cost increases make it more expensive to maintain the nation's roads, bridges and railway networks.

"In many areas the rough edges are already showing. About 25% of the bridges in the US are either 'functionally obsolete' or 'structurally deficient,' like the Mississippi River bridge that collapsed in Minneapolis in August, killing several people.

"Moreover, the pavement is rated 'non acceptable' on one of every seven miles of the nation's roads, according to the National Surface Transportation Policy and Revenue Study Commission, whose job is to assess infrastructure problems and recommend fixes. Overall, the commission estimates, $225 billion a year is needed to meet the country's transportation infrastructure needs. Current is about 40% of that level.

"'We were losing ground to these incredible increases in construction costs, but then to see the erosion in driving – it's a double whammy,' said John Horsely, executive director of the American Association of State Highway and Transportation Officials. On top of the federal gasoline tax, currently 18.4 cents a gasoline, the states charge their own gasoline taxes, typically ranging from 20 cents to 26 cents a gallon.

"The Bush administration is expected to release as early as Monday figures projecting a deficit of $5 billion or more in the Highway Trust Fund for next year. Thanks to the steady increases in driving, since it was set up under President Dwight Eisenhower, the trust historically has run a surplus. It collects gasoline tax revenue through a federal appropriation process before sending it back to the states.

"The prospect of the Highway Trust Fund running a big deficit has sparked a frenzy of lobbying on Capitol Hill in recent weeks, as business groups, ranging from the US Chamber of Commerce to the National Stone, Sand & Gravel Association, have pressed for as quick solution. "In recent weeks, Mr. Horsley's group has circulated a memo estimating that the states will lose a total of about $14 billion and roughly 380,000 jobs if Congress doesn't act to shore up the fund soon.

"On Wednesday, the House passed a bill targeting $8 billion for highway and mass-transit projects. The measure has a good chance of clearing the Senate as well, despite White House reservations.

"On Thursday, the House passed legislation that designates another $1 billion for bridge repair. House and Senate leaders are talking about including a significant increase in infrastructure spending in a possible second economic stimulus bill.

W.K.

"The problems facing Countrywide's servicing units go beyond a weak housing market and the credit crisis. In a number of court cases, judges are halting Countrywide foreclosures because they were based on servicing errors or improprieties."

Countrywide's Reputation Tarnished

"Countrywide's reputation as an efficient mortgage servicer has been tarnished repeatedly in recent months. Last March, the company came under blistering criticism from Jeff Bohm, a federal judge in Houston who told it to 'mend' its 'broken practices.' And the United States Trustee, a Justice Department units that oversees the integrity of bankruptcy courts, has sued Countrywide, contending that its tactics represent an abuse of the bankruptcy system.

"The final wild card in the Countrywide deck relates to shareholder lawsuits against it and continuing investigations into its practices. The Securities and Exchange Commission is examining its accounting and insider stock transaction. The Federal Trade Commission is investigating Countrywide as part of a broad inquiry into practices of lender and loan servicers. The FBI is looking for possible loan fraud, and regulators in Illinois and California are also investigating the company; its interest to the two states is whether it discriminated against minority borrowers."

At a time when the public is asking how investment banks "too big to be allowed to fail" got themselves in such a problem-ridden, boom-turned-to-bust-business, only one conclusion is possible: banks in the Federal Reserve System should be prohibited from acquiring interests in the other financial pillars – stock brokerages, insurance and mortgages.

For doing so puts within their acrobatic reach the cash reserves these other pillars need for their business. That not only places them in the privileged category of being too big to be allowed to fail, but that becomes their main capital asset, as they use the cash reserves of the "other financial pillars" as the legal tender base to hasten the exponential increase of the strictly computer-entry money they lend into existence. "Too big to be allowed to fail" under such circumstances guarantees that the central banks of the world are headed for the status of subprime institutions. There are too many public resources at risk since the deregulated large investment banks have their hands in the public purse.

W.K.

A Murky Internationalism

There is more in our central bank's "rescuing" us from the spreading subprime financing crisis than meets the eye. In recent decades since the banking system was deregulated and globalized, our government has been bailing out our banks about once every seven years. And in all but one such bailout, the astounding fact is that at the same time as the deregulated banks were bailed out from their major losses, they were being further deregulated. Indeed, that further deregulation – presented as part of the "cure" for their previous losses, could only ensure that the next bail out would not be long in coming. The only exception to that dazzling series of banking losses combined with their empowerment to gamble bigger if not better, was the bailout of the 1930s.

And the reason that they were not deregulated then is because they were practically non-functioning. 38% of the banks across the United States had actually shut their doors, and the rest were spared a similar fate only by the Roosevelt moratorium. The government stepped in with deposit insurance before they could even pretend that the banks were up to plain, honest banking once more. They had simply gambled themselves out of business. And when they were made a sickly whole once again, for the first time ever – before or since – they were strictly confined to banking and expressly forbidden to acquire interests in any of the other "financial pillars" – stock brokerages, insurance, and mortgage companies. Without that the Second World War could never have bee financed so successfully nor could there have been a quarter of a century of smooth and successful reconstruction from the havoc of the Depression and the war. The central government borrowed increasingly from its central bank. In the case of Canada, that had nationalized its central bank in 1938, the interest it paid the central bank on its borrows came back to it as dividends. In the United States, where the original private banks or their successors are still the shareholders of the Federal Reserve, almost the same proportion of the interest paid by the government comes back to it on other grounds – for having assigned to the central bank the monopoly of the ancestral monarch in coining precious metals.

It is only in the light of what made possible, indeed, unavoidable, this solitary instance of a bank bailout *without* further deregulation, that we can understand how the next even more disastrous financial adventure is being prepared at the very time that they are still groping to make good the banks' last gambling losses.

"Not Intervening Too Much with Markets"

The Wall Street Journal (19/06/08, "Paulson to Call for New Fed Role" by Kara Scannell) informs us from Washington. "Treasury Secretary Henry Paulson is expected to call for quick regulatory changes to the oversight of financial markets, including expanding the role of the Federal Reserve, in wake of the collapse of brokerage firm Bear Stearns & Cos.

"In a speech to be delivered Thursday, Mr. Paulson will say that the fall of Bear Stearns has expedited the need for the government to address the 'outdated' regulatory oversight structure while not intervening too much in the functioning of markets."

If ever there was a double-header you have it there. In what is delicately called "the expanding role of the Federal Reserve – which can only mean making good the bad debts of the bank-brokerage firm mentioned, but at the same time "addressing the outdated 'regulatory oversight structure' while not intervening too much in the functioning of markets."

There you have a fistful of semantic problems. How could this mean anything but that the central bank is to make good the debts incurred by Bear Stearns, but not interfering with "the market," or more reverently not hindering Bear Stearns or those who have acquired it repeating what in fact left the economy in the soup. The role of the Fed has simply been reduced to writing the requisite cheques, and following with pail and mop to clean up the mess on floor, walls and ceiling. In short, to set the stage for the next bailout on an even bigger and messier scale.

Treasury Secretary Mr. Paulson, will be less concerned with the state of the national Treasury after he has written the cheque to cover up the Bear disaster and addressing the other "market "casualties that wait their turn to be relieved of their losses. Once Mr. Paulson establishes this new Fed role that does not interfere with the "market," he will be allowing globalized deregulated banks onto all continents making good the indis-

cretions of our banks. The carpet has been laid, and the triumphant martial music for the future processions readied. And surely that is not only going to distract the Fed from its strictly banking business concerns and that is equivalent to ensure that deregulated bankdom will go on expanding into outer space at an exponential clip ensuring the legal tender of the land that happens to be identical with the credit of the federal government to provide interest-free from the Fed. You allow too much that is dark, alien, and incompatible with the legal tender of the country to get between the Federal Reserve and that, its prime task, and the government itself will find its debt to have become non-prime before it even realizes. And when that happens, everything that the US and world economies are already reeling under will appear child's play.

No matter what patchy accountancy reforms have been brought into government bookkeeping, central banks are once again back at their old game of pushing up their benchmark interest rates to prevent what they chose to call "inflation" most of the time merely reflected the faulty bookkeeping of our governments' accountancy. For in the US until 1996, and until 2002 in Canada, the government kept careful record of how much it owed on infrastructure investments like buildings, highways, and other capital government investments, but wrote off the asset value that such debt paid for in a single year, and thereafter carried it at a single dollar. That made for some fabulous privatizations – we need only mention the Canadian National Railways, privatized by a leading member of the government bureaucracy in a coup that would make an overnight privatizer in Putin's Russia blush with shame.

Come to think of it, in Russia it was in return for a magnificent fee to US economic consultants that invaluable national industries were privatized for a song. Though the US consultants were impatient to let the market do its magic there were no knowledgeable capitalists around in Yeltsin's Russia – just ex Secret-Service heavies, and top bureaucrats who knew where the valuable national treasures were buried. Now the same sort of "expertise" is to the fore in disposing of the subprime mess. It may be that in the long run the ex-Soviets will have the final chuckle, And of course, this has a vast relevance on national security that in other areas is so much to the fore in Washington's rhetoric.

W.K.

Hedge Funds Everywhere!

It is no accident that hedge funds that used to walk on gum-shoes with great discretion, suddenly seem to be all over the globe taking control. That is more than an illusion. With conventional banking on the defensive or worse under the burden of its subprime collateral debt-based assets, the very banks have become enticing victims for the huge funds to take over. Too often immobilized by their greed of yesteryears, the banks are unusually exposed to aggressors, who can spin a web of helplessness around their victims as a spider does his net. And with the latest derivative techniques of swaps, it is easy for hedge funds to disarm their victims. For indebted corporations unable to cash in their subprime assets, need money so badly to keep their creditors at bay. The strategists of the larger hedge funds, deliver a piece of the ensnared victim as bait for further partners with a far greater readiness than the victim can raise the means of mounting a defense. Contracts can be rewritten, purchase prices lowered, options on future shares imposed, while the travesty of the victim consenting when the bailiffs is on his way is cruel and ludicrous.

Nothing is too big for the larger and more unscrupulous hedge funds to attempt, and up to now get away with. However the resistance seems to be beginning.

The Wall Street Journal (13/06, "CSX Scores Partial Victory" by Dennis K. Berman and Peter Eavis): "A federal judge found that two hedge funds had consciously avoided securities laws in their proxy battle with railroad CSX Corp., in a decision that stands to reshape how activist investors move on their corporate targets.

"New York District Judge Lewis Kaplan rebuked the two funds, the Children's Investment Fund [that does sound innocent!] and 3G Capital Partners, saying they sought to justify their actions 'on the basis of formalistic arguments,' even when they had 'defeated the purpose of the law.'

"The decision gives ammunition to CSX as it wages the waning days of a bitter proxy fight against 3G and TCL, one of Europe's best known activist hedge funds. He found that the two funds had together plotted a bid for control of the railroad, but consciously, and illegally, failed to disclose their intentions.

"But it was not a total CSX victory, as Judge Kaplan grappled with how to punish the two funds. He said it was too late to reverse their actions, and that he was legally prevented from 'sterilizing' or 'neutralizing' the votes when shareholders choose a board of directors June 28. Instead. the funds were permanently enjoined from making future violations.

"The CSX case has been closely monitored by hedge funds, which were fearful that Judge Kaplan would take away some of their tools for acquiring big stakes of companies. They were especially fearful that he would take a skeptical view of swaps, which allow shareholders to create a kind of synthetic stock via private contracts with large Wall Street firms. These synthetic shares trade in tandem with a company's real shares, allowing a hedge fund to post economic gains without filing share-ownership reports required by securities law.

"Such arrangements have been legal for decades. Last week the Securities and Exchange Commission said it was largely alright with swaps, as long as they were not used to disguise takeover intentions."

"Still Judge Kaplan found that TCI and 3G used the swaps in a way that consciously allowed them to build a position while delaying such disclosure to the broader stock market. The swaps hung 'like the sword of Damocles over the neck of CSX.' Viewing these swaps as anything but regular shares owned outright, 'failed to take account of the practical realities of the world, and would be opened to the gravest abuse.'

"Challenging the SEC?

"Judge Kaplan appeared to take the SEC head on, saying that its views on the swaps generally 'exalts form over substance.'

"'I think it is a big deal because there wasn't a whole lot of legal precedent in this area,' said Nicolas Morgan, partner of DLA Piper. Gilbert Lamphere, one of the two people nominated by the two hedge funds for a seat on CSX's board, insisted that the funds acted properly and 'did it all according to the book.'

"'We always did what counsel said the SEC said we should do,' said Mr. Lamphere, a former railroad executive who now runs Lamphere Railway Management, a private investment firm. 'So the question is, What's the big deal? We didn't do anything wrong.' A spokesman for CSX said that 'the Court's ruling speaks for itself.'"

K.

Some Hidden Costs of Acting as a Bully Amongst Nations

As defective as the bookkeeping of nations already was, the psychological damage even to the alleged victors in the Iraqi war is just beginning to surface. The Good Lord created man with a conscience undoubtedly in the interest of our getting along and surviving as both individuals, with the members or our own community, and now – since those who run our world find it in their interest to learn to deal with some very different cultures whose territory we have chosen to consider in our own backyard. But to straddle the world with our own armed might, it would be helpful to study more about our own history and that of other peoples, rather than relying entirely on our superior weapons of destruction. Our government, however – even for its own narrow ends – has got its priorities addled. It is hardly surprising accordingly that the psychologically wounded among our own troops coming home are not always able to enter into normal relationships with their own communities. There is then a serious debit account that should be added to more readily recognized costs of our military adventures.

A good example is the article in *The New York Times* (08/07, "After the Battlefield, Fighting the Bottle at Home" by Lizette Alvarez): "Most nights when Anthony Klecker, a former marine, finally slept, he found himself back on the battlefields of Iraq. He would awake in a panic, and struggle futilely to return to sleep.

"Days were scarcely better. Car alarms shattered his nerves. Flashbacks came unexpectedly, at the whiff of certain cleaning chemicals. Bar fights seemed unavoidable. He nearly attacked a man for not washing his hands in the bathroom.

"Desperate for sleep and relief, Mr. Klecker, 30, drank heavily. One morning, his parents found him in the driveway slumped over the wheel of his car, the door wide open, wipers scraping back and forth. Another time, they found him curled in a fetal position in his closet.

"Yet only after his drunken driving caused the death of a 16-year-old cheerleader did Mr. Klecker acknowledge the depth of his problem: his eight months at war had profoundly damaged his psyche.

"'I was trying to be the tough marine I was trained to be – not to talk about problems, not to cry,' said Mr. Klecker, who has since been diagnosed with severe post-traumatic stress disorder, 'I imprisoned myself in my own mind.'

"Mr. Klecker's case is part of a growing body of evidence that alcohol abuse is rising among veterans of combat in Afghanistan and Iraq, many of them trying to deaden the repercussions of war and disorientation at home. While the numbers remain relatively small, experts say and studies indicate that the problem is particularly prevalent among those suffering from post-traumatic stress disorder, as it was after Vietnam. Studies indicate that illegal drug use, much less common than heavy drinking in the military, is up slightly, too."

Troubled Veterans Add to Crime

"Increasingly, these troubled veterans are spilling into the criminal-justice system. A small fraction wind up in prison for homicides, or other major crimes. Far more, though, are involved in drunken bar fights, reckless driving and alcohol-fueled domestic violence. Whatever the particulars, their stories often spool out in unwitting victims, disrupted families, lost jobs and crushing debt.

"With the rising awareness of the problem has come mounting concern about access to treatment and whether enough combat veterans are receiving the help available to them.

"Having cut away back in the 1990s as the population of veterans declines, the Veteran Health Administration says it is expanding its alcohol and drug-abuse services. But advocacy groups and independent experts – including members of a Pentagon mental-health task force that issued its report last year – are concerned that much more needs to be done. In May the House and Senate passed bills that would require the veterans agency to expand substance-abuse screening and treatment for all veterans.

"For active-duty service members, the military faces a shortage of substance-abuse providers on bases across the country, while its health-insurance plan, Tricare, makes it difficult for many reservists and their families to get treatment.

"In the breach, a few states, including California, Connecticut and Minnesota, have passed laws or have begun programs to encourage alternative sentences, often including treatment for veterans with substance-abuse and mental-health problems.

"In recent years the military has worked to transform a culture that once indulged heavy drinking as part of the warrior method into one that discourages it and encourages service members to seek help.

"'The Army takes alcohol and drug abuse very seriously and has tried to deglamorize its use,' said Lieut. Col. George Wright, an Army spokesman. 'With the urgency of this war, we continue to tackle the problem with education, prevention and treatment.'

"That is a tricky mission in time of war.

"'The problem in today's military is that soldiers have to be killers, do war, but we don't allow them any releases like we used to,' said Bryan Lane, a former special forces sergeant who sustained a traumatic brain injury in Iraq and has post-traumatic stress disorder or PTSD. 'You can't go out and drink, you can't start a fight. It's completely unrealistic.

"The military, he said, is trying to create a contradiction: 'a perfect warrior, and then a perfect gentleman.'

"Drum, in the North Country of New York, just outside Watertown, is home to the Army's most deployed brigade – the Second Brigade of the 10th Mountain Division. Late last year, several thousand soldiers returned after 15 months in Iraq. Some had served three, even four, tours, and they quickly overwhelmed the base's mental-health system. A study by an advocacy group, Veterans of America, found the demand for psychological help was so great, and the system so overburdened, that soldiers often waited a month to be seen.

"Many did what generations of homecoming soldiers have done: they salved their wounds in local bars. With drinking off-limits in Iraq, at least openly, they were that much more likely to binge, that much less able to tolerate it.

"The base commander, Maj. General Michael L. Oates, says that since his arrival in early 2007, misconduct related to substance abuse has reached 'unacceptable' levels, despite a toughened regimen of education, designated driver programs and penalties.

"'The rate of illegal drug use is slightly up, the rate of alcohol use is more than slightly up,' General Oates said. I am not against people drinking, I'm against misconduct.'

"Most returning soldiers re-adjust after a few months. But the general estimates that at least 20 percent turned to heavy drinking or drugs – typically the first signal that there is something wrong.

"Across the military, the precise dimensions of the problem are elusive, especially since the different branches largely keep their own statistics. Many studies do not distinguish between service members who have seen battle and those who have not. Moreover, behavior becomes harder to track when service members leave the military. Of particular concern are members of the National Guard and reserves, as well as re-

We've Gnawed the Bones of the Helpless Clean. Now Let's Get Into the Marrow!

The New York Times (5/07, "Credit Card Overhauls Seem Likely" by Jane Birnbaum) reports: "Consumer advocates say regulation of the credit card industry has long been without teeth. But as card holders struggle under the weight of big balances, high interest rates and fees, their pleas to lawmakers for help may well mean that the industry will face some significant regulation by early next year.

"Regulators are saying, 'We missed the mortgage thing by not acting quickly enough,' said Edmund Mierzwinski, federal consumer program director for the Public Interest Research Group. People are losing their homes because the banks were unfair. Now we've got the credit card industry. And people will end up in debt for the rest of their lives, and maybe we ought to do something.

"Until now, credit card companies have primarily been required to disclose their lending terms to borrowers. But consumer advocate have for years been saying that disclosure is not enough. They have been pushing the federal government to take firmer control over the industry – specifically spelling out the circumstances under which lenders can raise and calculate interest rates and impose fees.

"The proposed regulations take a big step in that direction. But they are strongly opposed by the industry, which has long beat back any regulatory constraints. Working with the Office of Thrift Supervision and the National Credit Union Administration, the Federal Reserve introduced its proposals in early May. It has asked for comments and expects to formalize proposals by the end of the year.

"The legislation most likely to succeed in both the House and the Senate sets similar rules on consumers' behalf. Representative Carolyn B. Maloney, the Democrat who wrote the House bill, and Christopher J. Dodd, the Democrat of Connecticut behind the Senate measure, said they planned to bring their measures to the floor for votes before Congress adjourns in September.

"The House and Senate bills as well as the Federal Reserve require the lenders apply payments to the debt with the highest interest rate."

That, of course, would leave less of the non-payment to come under the punitive rates. Fail to do that, a jobless card debt using his credit card to cope with an eviction due to a subprime mortgage situation, and you will have people chained in ever heavier debt for life.

"All would ban 'double cycle' billing, in which interest is charged on some already repaid debt, and all would extend the time, currently 14 days between a statement mailing and payment due date.

"All the measures would prohibit lenders from raising interest on existing debt. The central bank proposes that except for increases caused by changes in stated variable and introductory offers, lenders may increase interest rates only if minimum payments are more than 30 days late.

"Only the Dodd bill prohibits charges for paying by mail, phone or online, and restricts marketing and offers of credit to consumers under 21."

Credit Cards Oppose Regulation

"The credit card industry continues to stand firm against regulation, especially law made by Congress. John G. Finneran Jr., the general counsel at Capital One Corporation, testified in House hearings in Match that 'it would be unwise – especially at this time – to enact broad legislation that sets payment formulas in statute, features and tools of risk management for consumer credit.' Fewer balance offers could stifle job creation by entrepreneurs who use credit cards to borrow at the lowest possible cost, added Ken Clayton, senior vice-president for card policy at the American Bankers Association in Washington.

"According to Cardtrak.com, a research company in Naples, Fla., the median balance among the approximately 53 million households carrying general-use card debt from month to month is about $6,700, up from $5,900 five years ago. And with the economy slowing and unemployment rising, growing numbers of card holders are unable to keep up with their payments.

"Representative Barney Frank, Democrat of Massachusetts and chairman of the House Financial Services Committee, said the Federal Reserve acted last fall after the House approved legislation that would have transferred some of the Fed's regulatory power to other agencies.

"Randall S. Kroszner, a Federal Reserve governor, said the central bank began considering the need for additional rules to protect consumers last year after it reviewed the comments on its proposal for greater lender disclosure of credit card terms. Many of these comments were submitted by consumers who indicated in many cases, disclosure alone was not enough, Mr. Kroszner said.

"The House measure has 149 co-sponsors. Twenty of them, including two Republicans, sit on the 70-member House Financial Services Committee that must approve it before the House can vote.

"Mr. Dodd said he is hoping to get bipartisan support in the 21-member Senate Banking, Housing and Urban Affairs Committee that he heads. He said, 'People must do something, whether organizing online or through community coalitions, or calling their elected representatives.'

"Adam J. Levitin, an associate professor of law and credit and credit specialist at Georgtown University, said the proposed rules do not go far enough.

"'When the Federal Reserve or Congress tries to nip off specific abuses that the credit card industry practices, it becomes a game of Whack-a-Mole,' Mr. Levitin said. As soon as they put the kibosh on one, the industry figures out another. I don't think Congress or the Fed has recognized that reality yet, or has the political will to do it."

And thus it goes towards the next mega-credit crisis.

W.K.

cently discharged service member, who can lose their bearings outside camaraderies and structure of the military.

"In the Army, which has the bulk of the troops from Iraq and Afghanistan, the Pentagon's most recent survey of health-related behavior, conducted in 2005 but just released last year, found that for the first time in more than 20 years, roughly a quarter of soldiers surveyed considered themselves regular heavy drinkers – defined as having five or more drinks at least once a week. The report called the increase – to 24.5% in 2005, from 17.2% in 1998 – 'an issue of concern.'

"Heavy drinking or drug use frequently figures in what law-enforcement officers and commanders at military bases across the country say is a rising number of crimes and other examples of misconduct involving soldiers, marines and recent veterans.

"From 2005 to 2006, for example, 'alcohol-related incidents' – mostly drunken or reckless driving and disorderly conduct – more than tripled at Fort Hood, Tex., according to information released to the Pentagon task force. The Marines, filled with young men drawn by the corps' hard-charging image, have traditionally had the military's highest drinking rates…. The Marines also reported a rise in alcohol-related incidents.

"Earlier this year, a *New York Times* examination of killings in this country by veterans of Iraq and Afghanistan found that drinking or drug use was frequently involved in the crimes. Last month, a soldier at Fort Bliss, outside El Paso, was charged with killing a woman in a drunken-driving accident – the third intoxicated soldier there accused of killing a civilian in six months, said the commander, Maj. Gen. Harold B. Bromberg.

"Substance use frequently figures in soldiers' lives, which reached a high in the Army last year: alcohol or drugs were cited in 30% of those 115 cases, the Pentagon reported.

"Running through many of these soldiers' lives is combat trauma or other scars of war.

"In part the dynamic is rooted in the warrior code. Trained to be tough and ignore their fear, many combat veterans are reluctant to acknowledge psychic wounds. Or they worry that getting help will damage their careers.

"In the last decade, the military has rolled out a number of programs to deal with excessive drinking. Soldiers carry call-a-cab cards. One base hands out portable breathalyzers. A new online campaign pokes fun at 'That Guy,' a military man who drinks too much and ends up embarrassing himself and in trouble.

"Yet many experts and veterans advocates, as well as some government officials, agree that treatment continues to lag behind awareness – in terms of access, but also in willingness to use what is there. Studies show how few of the problem drinkers receive treatment.

"The *Times* article began with Anthony Klecker it takes its leave of us with him.

"Klecker experienced the brutality of war early, enduring ambushes and firefights as one of the first marines to fight from Kuwait to Baghdad and on to Tikrit. What torments, though, is the uncertainty."

The Torments of Uncertainty

"As the gunner on the rear Humvee in a First Marine Division convoy, Corporal Klecker was charged with making sure that nothing – no cars, no Iraqis – came too close. In the distance he saw a man in farmer's robes running towards his convoy and fired a warning. Suddenly a white civilian van came hurtling up the road and Mr. Klecker fired another warning, then let loose several bursts of machine-gun fire at the van and the man. The van stopped.

"Mr. Klecker said he did not know if he had killed them – though he assumed he did – or if they were innocent Iraqis. Still, he says. 'I was proud. I had a lot of adrenaline.

The Future of Money?

Money, Myths and Magic explained why money must be constantly created in the vast quantities needed to support today's globalized trading economy of some 6 billion people. New money now enters circulation following conventional bookkeeping practice in which dollar liabilities must equal dollar assets. This requires newly created money be "balanced" by a newly created debt, a debt which has no more substance than the new money, both created by bookkeeping entries! But these new debts earn interest which can only be paid with more new money.

A bookkeeping system better suited to modern needs would introduce newly created legal tender as direct payment of basic national costs, e.g., constructing new hospitals, schools, highways, railroads, internet; educating physicians, scientists, engineers, teachers; public health maintenance. These direct payments would be carried on the "books" as investments in the future of the nation, "balancing" the newly created legal tender against the miles of highway graded and paved, the number of college graduates produced, the number of hospital patients treated – not by a dollar denominated interest paying national debt.

As described in *Money Magic* legal tender once introduced into commerce remains part of the ever growing money base private banks use, as they once used gold coins, to further increase money in circulation by the process of fractional reserve banking. There would be new debt backed money created as well as legal tender but no new national debt created!

A basic role of government is to "promote the common welfare" by which private initiative can thrive and citizens can be "secure in their persons." One of the very first US government actions was to create and operate the US Postal Service to guarantee the flow of information. The US Patent Office was created to secure personal property rights to inventions. Maintaining an army, navy, navigable waterways, federal judiciary, were more financial and administrative functions of the new USA.

The federal government now spends much money directly and through grants, subsidies and tax rebates. This proposed new method of bookkeeping would eliminate new national debt and the accompanying fantasy of ever paying it off, an impossibility which presently clouds all discussions of government spending. With no dollar deficit more rational discussion of government spending could ensue. Just as private banks consider the use to which their loans are put and the prospect that they will be productive enough to enable interest to be paid, so too would Congress be obliged to consider national investments it makes with debt-free new legal tender. Certainly one important consideration would be to not fund frivolous unproductive projects which simply put new money into circulation with no real public benefit. This would be classic money printing clearly debasing the value of new legal tender, a historic cause of rapid price inflation.

Robert W. Zimmerer

I did my job.'

"Later though, the incident no longer seemed so clear-cut. 'I started to feel a sense of shame,' he said, 'shame if I did the right thing or didn't.' Really much what an increasing number of Americans and Canadians and other invaders of Iraq and Afghanistan are feeling – a growing smidgen about the presence of our military in those lands on clearly cooked-up pretences.

"Soon after he left the Marines and returned home to suburban St. Paul in Minnesota, his panic attacks, nightmares and insomnia worsened as did his drinking. He rarely spoke about the war, and only to other veterans."

Talking About Iraq Causes Veteran to Panic

"Soon he racked up arrests for drinking and fighting, and he was persuaded to go to the Veterans' Affairs center for help. As often happens, the experience did not take. Mr. Klecker says he was shuttled from one counsellor to another. Trying to talk about Iraq threw him into a panic.

"He hit bottom on Oct. 28, 2006, when he drunkenly drove into a highway divider. It dislodged, trapping another driver, Deanna Casey of Minneapolis, who was killed when a tractor-trailer rammed her small car.

"If I could switch my life with Deanna's I would do it in a heartbeat,' Mr. Klecker said. 'I didn't ask for help and I should have.'

"Afterward, Mr. Klecker received a full veterans disability rating for combat stress, At his trial for vehicular slaughter, the judge recognized the war's role in his disintegration and accepted his lawyer's request for a special deal. After a year in jail Mr. Klecker moved into an intensive in-patient program at the St. Cloud veterans' facility to deal first with his drinking and then with his combat stress.

"Last November, still untreated for combat trauma, Mr. Klecker grew agitated and pulled a pocket knife on a fellow-patient after an argument.

"He was forced to leave the inpatient program and wait for an outpatient slot. In February, the judge ruled that Mr. Klecker could not serve his sentence at home, and returned him to prison for 19 months."

There is no clear line between invaders and victims in Iraq or other militarily contested lands. War and the politics of greed that lead into it, takes their toll on what may remain of humanity on either side.

W.K.

Fannie and Freddie Orphaned in the Storm

Of all *The New York Times'* stable of economic reporters one of the most talented to my mind is Gretchen Morgenson. In recent weeks she has marched right to the brink of the cliff and looked fearlessly what may lie below. Undoubtedly this unusual degree of frankness of the print media is not unconnected with the crisis that they are undergoing in their own business from the competition of the blogs. However, the greatest still missing ingredient would help us understand how we got out of the Depression of the 1930s, and why, ignoring those dearly bought lessons, we risk heading towards a still greater mess than that of the 1930s. I say "greater," because the technology of mass extermination has, unlike the teaching of economics, made fantastic progress since those primitive days.

But let's listen to Ms. Morgenson as she recounts the most recent economic shock (*Times,* 13/07, "The Fannie and Freddie Fallout"): "It's dispiriting indeed to watch the United States financial system, supposedly the envy of the world, being taken to its knees. But that's the show we're watching, brought to you by somnambulant regulators, greedy bank executives and incompetent corporate directors.

"This wasn't the way the 'ownership society' was supposed to work. Investors weren't supposed to watch their financial stocks plummet more than 79% in less than a year. And taxpayers weren't supposed to be left holding defaulted mortgages and abandoned homes while executives who presided over balance sheet implosions walked away with millions.

"Over the course of this 18-month crisis, we have lurched from land mine to land mine. Last week [featured] Fannie Mae and Freddie Mac, the giant government-sponsored enterprises set up to provide affordable housing across the nation. By issuing debt, these shareholders guarantee or own more than $5 trillion in home mortgages. Got that? $5 trillion.

"Because the federal government established the companies, investors view them as backed, at least implicitly, by taxpayers. And that implied guarantee is what drove Fannie and Freddie's business models.

"The advantages the companies gained from this unique arrangement were huge. They had to keep less cash on hand than traditional lenders, for example. They also made more money than traditional lenders, for example because they paid less to borrow money in the bond market. These profits enriched Fannie and Freddie shareholders over the years and bestowed significant wealth on the companies' executives."

Now it looks as if the bill for that largess is coming due. Of course, it will be borne by the usual bagholders – US taxpayers.

"For years, anyone warning that Fannie and Freddie should beef up their financial positions was ridiculed and run over by the lobbying machines these companies kept oiled and close at hand. So their lucrative arrangement remained the same: business as usual, with all its riches, was the goal. After all, wasting money by inflating their cash cushions would just crimp their style.

"Suddenly, Fannie and Freddie's relatively anemic capital supply is a concern. Last week, Fannie's stock plummeted to $10.25, down 74% in 2008. Freddie's shares also dived, closing at $7.75, a loss of 77% this year."

Legal Tender Tied to Subprime House Sales

"Even as investors were stampeding out of these stocks, the claque in Washington rushed to reassure them. Both Ben S. Bernanke, the Federal Reserve Board chairman, and Henry M. Paulson, Jr., the Treasury Secretary, said the mortgage giants' regulators confirmed that the companies were 'adequately capitalized.'

"That was supposed to signal that the companies wouldn't have to raise capital immediately because regulators had the problem firmly in hand. But investors have good reason to be skeptical. In the first half of 2007, both Mr. Bernanke and Mr. Paulson sang a similar tune when they opined that problems in the mortgage market were 'contained' to subprime loans.

"Talk of adequate capital also brings to mind comments made last March, when Bear Stearns was on the ropes, by Christopher Cox, the chairman of the Securities and Exchange Commission. He tried to calm investors by telling them that Bear Stearns passed financial muster. Days later. the firm was toe-tagged.

"Which brings us to the main problem: credibility. Wall Street and our senior regulators seem to be running out of that precious commodity almost as quickly as of cash.

"It wasn't as if this problem came out of left field. Fears that Fannie and Freddie were getting too big have been a recurring theme in recent years. And Congress had ample opportunity to create a new regulator that would be vigilant about ensuring the safety and soundness of both companies.

"But even after and both the Fannie and Freddie companies were found to have accounted for their results improperly. Freddie in 2003 and Fannie in 2004, Congress had failed to act. As a result, Fannie and Freddie were allowed to become high-growth companies and stock-market darlings."

There should be no surprise that the government officials who cleared the paths of sensational advancement for Fannie and Freddie should have background as corporation executives behind them, or aspired to one after leaving public office. The wave of corruption of elected representatives and officialdom was all-embracing, reinforced by the suppression of the Rooseveltian banking reforms in our universities and the media. It was a seemingly unbeatable combination of planned ignorance of everything we had learned before during and after the Great Depression at a staggering cost of which WWII was only an instalment. When crucial chapters of history are suppressed, the world is reduced to a free field for speculative bank capital to romp in.

Canada's Most Brilliant Monetary Coup

Textbooks have been rewritten to omit what is undoubtedly the most greatest initiative that Canada was able to take among nations – the nationalization of its central bank in 1938. For that opened up the possibility of the federal government financing its investments at clear near-zero interest costs – since the profits of the Bank of Canada come back to the federal government as dividends. And the interest paid by the central bank on the loans made to the provinces by the BoC and even to the municipalities – the latter with the guarantee of either a provincial or the federal government, would also end up with the federal government. That would have made it unnecessary for the federal government to down-load onto the provinces vital social programs without adequate funding to take care of them. This was for no better reason than that the federal government had been bailing out the ever-more deregulated banks from their ever mounting gambling losses in acquiring the "non-banking financial pillars that they had been barred from by the Rooseveltian bank reform that came to serve as model for other countries like Canada. It would have restored some sanity to the constant wrangling over payments and money that the relations of the different government levels of government have become.

Instead, much of what we should learned from our history, has been suppressed. The high price of gasoline and other fuels and the damage to the environment and human health by the pollution of the environment, properly considered must sooner or later lead to our governments realizing that price dimensions are intimately related to the space dimensions over which the goods or the raw materials for their production must travel to be produced and consumed in any given country. We have just begun to learn this – the hard way, with eyes and mind closed. Over several decades the relevant groping of economists towards a recognition of such relationships has been suppressed. So long as it adds the Gross Domestic Product, and the profit rates of our large financial corporations. It was left to the allegedly self-balancing market. The misconceived notion of economic growth at an ever sped-up pace on a finite planet has led to needless mileage and fuel consumption, and damage to our environment, in the interest of higher speculative profits of the financial sector.

This recognition of the space and price dimensions as part of a single inter-related complex is not unlike Einstein's realization that the time dimension is part of an interrelated complex with the three spatial dimensions. But then if governments and universities had suppressed what Galileo and Newton had taught us, there could have been no way in which human kind could have grasped such more involved interrelationships when the time dimension (as in velocity and acceleration) becomes large enough to be picked up in the spatial dimensions. A parallel effect is now being noted today in the space-price dimension complex. Industries that migrated from the US to China, are starting to move back to the US or to Mexico, because the high cost of fuel and congested container space in Asian ports.

However, so long as we take zero inflation enforced by high interest rates as gospel we will be unable to deal with the more realistic problems that are starting to catch up with us.

In the light of that, the dense concentration of housing abandoned because of the subprime crisis, *can* lead us to some very basic conclusions in orienting ourselves towards a solution of some of the immense problems confronting the world today. It can, for example, lead to a shift of population from home ownership for people of modest incomes in distant suburbs to rental housing built closer to their work-places near city centers or where mass employment is more readily available. But to take care of the displaced families, public housing financing by the government at near – zero cost through our central bank to provide good and new rental housing owned by the government, with adequate parkland and educational and recreational facilities nearby. Government loans comes back to it in the forms of dividends – our central bank was nationalized in 1938, but little use has been made by the government of this facility since the 1970s, since government borrowing was shifted from the Bank of Canada to the private banks in the early 1970s as a means of bailing out the banks from their heavy losses in non-banking speculations that had been forbidden them under the Canadian version of the Rooseveltian restrictions on banks.

Zero Inflation Enforced by High Interest

This – similarly financed through the Bank of Canada though projects of the federal government must include adequate parkland, playgrounds, new schools, that will be very different from inadequately serviced rental communities built several decades ago. In the hands of the federal government financed through the Bank of Canada it will leave the occupants free of mortgage debt. Since the move will be towards from the suburbs towards the center of cities and near the sites of larger industries to save transport costs it will ease the strain on our transportation systems, and hence the pollution of our environment. It will be logical corollary to the high fuel price and the pollution of the environment, that will leave in the public domain land bound to appreciate in value during the expectant usefulness of the new public housing properly serviced with educational and parkland provided in adequate quantity and quality. It would be bringing together several basic discoveries of economic theory during the Depression of the 1930s, WWII, to mention a few, the purposes originally intended for the *Bank of Canada Act*, which is still on our law books.

The 1980s — An Earlier Gamble on Mortgages

The tale winds on. In 1988, the banks gambling with mortgages just as they did more recently lost most of their capital in the US taking over the S&L mortgage trusts. To reconstitute their capital, the Bank for International Settlements, a sort of central bankers' club dedicated to deregulating banks, declared that since debt of advanced countries was "risk-free," the banks could accumulate as much if without putting down any down payment. As a result the banks of Canada were able to quadruple their holdings of government debt to $80 billion dollars. without putting up a penny of their own money. At the same time the BIS raised interest rates to over 20% to "lick inflation." What BIS and the central bankers it gathered around it overlooked in the urgency of that bailout was when you raise interest rates pre-existent bonds drop in market price like rocks. It almost brought on a world banking crisis. As a result, the US government not only put together the largest standby fund up to that to avoid a world bank collapse, but actually brought in double-entry bookkeeping, evaluating the depreciated value of all the assets of the federal government. The process was carried back to 1959, and the results turned up for the first time in the statistics of the Department of Commerce but under the heading of "Savings." Which of course, they were not, since "savings" implies cash or short – term, high-quality securities readily convertible into cash. But a nudge and a wink to the bond-rating agencies sufficed to raise the ratings of government securities, and that in turn brought down the interest rates the government had to pay on its securities. That gave Clinton his second term as president and the United States the high-tech boom that led to the Big Bust of 2000.

Emboldened by the introduction of double-entry bookkeeping into the US government accounts, the Canadian Auditor General refused to approved two successive balance sheets of the federal government in Canada unless this were done in Canada. But after many weeks of arguing with the then Finance Minister Paul Martin during which the Auditor General even accused the Finance Minister of "cooking the books." Martin agreed to bring in capital budgeting, but only after he had imposed a demeaning declaration to the effect that since no new money had been brought into the Treasury, it would not warrant further programs.

The concern was to defend the priority of the Treasury's resources for bailing out the banks from their every greater involvement in non-banking areas of the financial sector – stock brokerages, insurance, and mortgages.

A low value booked for government assets – even if no longer a token dollar before double entry booking were brought had another purpose. The lower the value the more profitably key government assets – downtown sites in leading cities coast to coast booked at a fraction of their real value, let along their inevitable increase in value in response to any infrastructural improvement of any level of government in the area, or even private developments in the area.

Even the Government's policy of doing its banking with the private banks rather than with its own bank, the Bank of Canada, of which it is the sole shareholder. Let me cite an example.

At the moment in just about every major city across this broad land, choice federal real estate is has been put up for sale on a 25-year lease back arrangement. The government sells the building and leases it back for 25 years. The Normans in Britain almost a millennium ago saw the potential of hanging on to land sites where two Roman Roads crossed. They would never part with the site, but would lease it and/or the building for a century. That is why the Normans prospered far beyond other French noble lines.

On the southern side of Front Street in Toronto is a block of the Post Office running from the central railway station to the west to a theatrical area to the east. Across the road are two bank headquarters of an elegance that I don't believe is matched else or surpassed in the city or I believe the land. Infrastructural developments of any level of government, or any elegant buildings in the area cannot fail to enhance the value of the land under the Post Office, an elegant historical building itself. The official version for the sale is that the Government has not the money to maintain it properly. Ridiculous. Will it have applied for a mortgage from the Bank of Canada, and would the Bank's single shareholder have been turned down? Or was it that it continued avoiding a serious appraisal of the building it has put up for sale? It is with fairy stories of this sort that politics are made. Why has nobody in Parliament asked this and other questions? One thing is certain: at the end of the 25-year lease-back the government will not be able to buy back what it is in the process of selling needlessly as a political plum.

And when you start asking, you must continue to enquire for the reason that the *Bank of Canada Act* is still on our books. Any one can find it through Google and by consulting section 2, subsection 14(b) and 17, 18 (c), (f), (g) you will find that the bank has one shareholder, the government of Canada, in the event of a disagreement with the Minster of Finance, the Minister shall given in writing the course to be followed, the Bank may borrow against funded or unfunded debt of the federal and any provincial government, or any corporation against guarantee of the federal or a provincial government. The latter would include any municipality with the guarantee of the federal or a provincial government.

The Heritage of Brian Mulroney

There remains one question. Why is this document so damning for the governments who have ignored its existence, been allowed to continue as law of the land, utterly ignored? Thereby hangs a tale. It takes you back to the time when Brian Mulroney was Conservative Prime Minister of the land, and Canada's constitution was being formulated. Mulroney proposed that two items be put in the Constitution: (1) that the Bank of Canada is independent of the Government of Canada. This is a most remarkable suggestion, given subsection 17 that sets forth that all the outstanding shares of the central bank are held by the Queen on behalf of Canada; (2) zero inflation must be maintained. Mulroney's Commons Finance Committee turned him down on this, and since then no government has dared raise these matters again – or even mention them. That, unfortunately goes for all parties represented in the Commons or the Senate. It leaves Canada's democracy, well-smoked, hanging from a hook. And during election campaigns it is de rigueur – especially in the hand-picked Canadian Broadcasting Corporation' phony discussion groups with a party leader. with somebody in the carefully screened audience, asking the high politician how much the debt will be paid down and when it would be completely discharged? How and when this could happen is a secret. As is what will this good land use as currency, since the debt of the federal government is the only legal tender in the land. Reduce it by 25% and you will worse the depression that is already closing in upon us. Pay it off completely, and you shut down the economy – we become a country without a currency. We could always import some of their currency from Zimbabwe, of course.

William Krehm

While We Were Predicting the Worst, It Had Already Come to Pass

What concerned COMER almost from the very beginning of the subprime mortgage mess was that it risked debasing the only legal tender in the US – and to an extent even in the world – to the status of just another subprime loan. For since Washington left the gold standard in 1971, the only legal tender was the credit of the federal government. That was because behind it clearly stood the taxing powers, the vast investment in human creativity and know-how, and physical investments and environmental care of the US. And keep in mind that after WWII and Bretton Woods only the US was really on the gold standard. Other countries were in fact largely on the American dollar standard, and their relation to the gold standard even when that existed came through their holdings of US currency. With that in mind, it should be apparent if you have the US government exchanging good American dollars for subprime mortgages or other debt that the government has taken over to bailout corporations that had gambled too irresponsibly, you undermine the clear sovereign backing of the US dollar – the credit and credibility of the US government.

To make the point, we went so far as to suggest that whereas the debt of the US government or of any developed country has the same negative sign before it as any other debt, that in fact should be distinguished from the negative signs before the debt owed by private sector entities. It should in fact carry a positive sign because when the government spends credit from the central bank, it is creating legal tender.

There is a simpler and more powerful way of making the point. And we made it that way as well. To prevent the collapse of the monetary systems of the world, when bailing out the banks from their heavy losses in taking over the US mortgage trusts in the 1980s, the Bank for International Settlements – the war room of the world banks' deregulation efforts to bring back their glorious period of speculative freedom that led the world into the Depression of the 1930s and World War II, BIS had declared the debt of central governments of advanced lands risk-free and thus eligible for banks to load up without down payment. As a result of that, Canadian government quadrupled its borrowing from the private banks to $80 billion.

Since the Canadian federal government was the sole shareholder of the Bank of Canada since 1938, when the government bought out 12,000 private shareholders at a good profit, the interest it had paid on its borrowing from the BoC came back to it almost entirely as dividends. Shifting that debt of the government from the Bank of Canada to the private banks meant that the government headed by Brian Mulroney not only bailed out the banks from their gambling losses, but tried going much farther. He pressed for putting two clauses into the Canadian constitution that was drawn up in 1982 that declared the Bank of Canada independent of the government of Canada. Although the government had paid its 12,000 shareholders good money when it bought them out in 1938. Also, Mulroney wanted to put into the Constitution the need to maintain zero inflation. However, his own House of Commons finance and banking committee voted against the proposal. As a result nobody has dared touch the *Bank of Canada Act* as it was drawn up in 1938 when the central bank was bought out by the government. So there you have Canada's unspoken shame – the basic act structuring our economy is still intact on the law books – you can find it on your internet with the help of Google, but it is completely disregarded by both the central bank and the government. From there everything about morality in our politics is programmed to go downhill.

But the BIS is not attuned to such delicate moral issues. So when the Mexican government was teetering on the brink of bankruptcy, in the early 1990s, because the North American Free Trade Agreement ruled out protective tariffs, and impediments to the movement of currencies across frontiers, the flight of capital out of the country and the influx of foreign goods chopped the legs off their economy. Unemployment and bank insolvencies multiplied. Its banks, privatized just a few years earlier from an earlier nationalization, were nationalized once again. Well-connected financiers sent their gambling profits out of the land without hindrance well in advance, and the collapse of the Mexican economy – living standards dropped fully 40% – threatened to bring down the world monetary system. So to save the situation the Bank for International Settlements, knowing only one remedy for all complains – raised interest rates close to the skies.

But in their haste to bail out the world banks from the billow of insolvencies moving upon them, the BIS and all the central bankers it gathered around its knees overlooked an important detail. When you raise interest rates the hoards of bonds issued earlier with lower interest coupons, plummets. And when interest rates touched and went beyond the 20% range the banks – loaded with debt bought wholly on the cuff, found itself in trouble. Hastily, without even consulting Congress, the Clinton government put together the largest standby fund up to that time – $51 billion, $25 billion each from the US and the IMF and one billion from Canada – one of the first fruits of NAFTA. That standby fund wasn't used, but helped bring the panic under control. To Clinton's Secretary of the Treasury, decided that the days of sky-high interest rates were over, because they were incompatible with those government bond hoards acquired with no deposit which the banks had such desperate need of. As a result, and here we rejoin the main line of our story, the government for the first time introduced double-entry bookkeeping into its account – something that the Templars are supposed to have brought back from the Holy Land almost a thousand years ago. What until then despite the recommendations of four royal commissions and countless auditors our government had resisted doing. When the government built a building, a road, a bridge, or whatever, it carefully amortized the debt that was incurred over a period roughly equivalent to the useful life of the asset created, but the value of the asset itself was written off in a single year, leaving the debt but not any estimate of the value of the capital asset it had paid for. Obviously this utter lack of serious accountancy was immensely useful in providing highly profitable privatization deals. You could multiply the book value of the asset – by ten thousand – for a building or a length of highway, and lease back to the public what as taxpayers they have already paid for fully. Throughout the world in fact, highways,

railways and buildings have been sold to special international corporations that specialize in toll income. The CNR, the more northern of Canada's transcontinental railways was in fact privatized and sold to a very leading civil servant – something that one would expect to happen in a corrupt Latin American land. However if you start with crooked bookkeeping, the door is thrown open for any sort of corruption.

But getting back to the distinction between central government debt that should have a large positive sign before it to prevent confusing it with non-sovereign debt, we might note that the acknowledgment of the value of government investments in its accountancy (in the US as of 1996, and in Canada six years thereafter) is now confined to *material* investments. To this day in both Canada and the United States and most other countries throughout the world, money invested in human capital – education and training, and hence inevitably the vessels in which these are conserved – health, and social services, are still not treated as assets.

Elsewhere we have fought to keep alive the memory of Theodore Schultz of the University of Chicago. As a young man he with hundreds of other young economists were sent by Washington to Japan and Germany to study the war damage and predict how long it would take for those two countries to rebuild sufficiently to become the formidable competitors that they had been before the war. Twenty years later, Schultz wrote that it is remarkable how wide of the mark their forecasts were. This he ascribed to their having concentrated on the physical destruction, but ignored the fact that the highly educated and disciplined work force of these two defeated countries had come through the war essentially intact.

For that historic conclusion Schultz for a year or two was feted around the world and even awarded the Bank of Sweden Nobel price for Economics. He was even invited to Canada by the second Governor of the Bank of Canada, Louis Rasminsky. But his conclusion was buried and forgotten because it ran counter to an important finding of yet another great economist, the Frenchman François Perroux, the "dominant revenue." This recognizes that the revenue of a particular class or social group by its volume and rate of return is taken to indicate the degree of well-being of society as a whole is judged. Schultz's great discovery was denied incorporation into the official body of economic doctrine because it ran counter to the interests of the dominant revenue of our period, which is speculative finance that claims to forecast the future and take a profit on it in advance. Its contrivances to maximize this revenue revolve around interest rates, and the higher powered derivatives of these, which are believed to foretell the

History Should Not Be Reserved for Post Mortems

There is nothing more important in humanity's survival kit than a knowledge of history – our own, and now that we have been conned into unlimited so-called "globalization" – that of other peoples.

It is late in the day for the Americans and our own government that chose to collaborate with the American military in Afghanistan – mistaken for a mere peanut to crush as compared with Iraq. Those in the top levels of our military, our diplomacy, and of course, our universities, who recommended that that backward country as a military pushover should be awarded PHDIs – Philosophical Doctors in Ignorance.

Particularly since the Americans supported the disastrous resistance to the Russian conquest of that backward land that contributed in no small degree to the ultimate collapse of the Soviet regime.

Now we are learning even from Russian sources all about Afghanistan's record as a trap for some of the world's more formidable conquerors. It is late in the day for Western press to be recounting to us the drubbing the Soviets took in Afghanistan (*The Globe and Mail,* 12/07, "It's Impossible to conquer the Afghans" by Paul Koring): "Moscow – Head bowed, exhausted, the statue of a young soldier back from Afghanistan's killing fields is flanked by long, grim lists of his dead comrades. It's a cautionary monument for Western politicians and generals who boast they will succeed where the Soviets failed.

"In Russia, a country chock full of heroic memorials to enormous military sacrifice, the uniquely dejected pose of the helmetless combat veteran in the Ural city of Yekaterinburg is a sobering reminder that great powers have an unhappy history of overreaching and then being driven ignominiously from Afghanistan.

"'Canadians and Americans are learning the hard way. You have been there seven years and you have no prospects of an early victory,' said Ruslan Aushev, a highly decorated veteran who served two tours, totalling nearly five years with the Soviet army in Afghanistan. 'We knew by 1985 that we could not win. It then took Moscow four more years to extricate hundreds of thousands of troops from Afghanistan, while claiming victory on the way out.'

"'Most Afghans still live in a feudal society, in villages far from the cities,' he said. 'For them, there is no difference between being bombed by the Soviets and now being bombed by the Americans and it won't succeed. We could take any village, any town and drive the mujahdeen out,' Mr. Aushev said, recalling his two combat tours, first as an infantry battalion commander and later in charge of a full Soviet regiment. 'But when we handed ground over to the Afghan army or police they would lose it within a week.'

Koring provides a list – available to anybody in the *Encyclopedia Britannica* or any public libraries of the forerunners of President Bush and Prime Minister Harper in trying unsuccessfully to conquer Afghanistan. These include:

"Darius the Great. In the later sixth century BC much of this country was absorbed into the Persian empire of Darius the Great. However, plagued by constant uprisings, the Persians never established effective control.

"Alexander the Great. In the third century BC, Alexander the Great invaded. The harsh mountainous terrain and brutal weather were only part of the challenge. The Afghans themselves were no less formidable. Constant revolts undermined whatever glory he could claim.

"Genghis Khan. In 1220 the Islamic lands of Central Asia were overrun by the armies of the Mongol invader. But even Genghis Khan failed to destroy the strength of Islam. By the end of the 13th century, his descendants were themselves Muslims.

"Britain. There were three major interventions by the British Army between 1838 and 1919, Each ultimately failed."

This and much else in the history books can be absorbed in comfortable libraries at home, without writing it in the blood of tens of thousands of our young men.

William Krehm

future even if by swaps and other derivative of growth rates. These come to approximate the exponential rate of increase which is the mathematical expression around which the atomic bomb is structured.

For our purposes Schultz provided just what we needed to put a positive sign before the recognized investments in government investments into more than a large positive sign to distinguish them from all other debt. In this way we could fix in the public mind that what we call "government debt' is a misnomer because it is the result of the absence of serious double entry accountancy when it comes to the investments of our government in physical and human capital. For not only would the latter have unusually long periods of depreciation that span generations. The children of educated parents tend to be more readily educated, better adjusted and confident of their role in society. Government debt would undoubtedly turn out to have violated serious accountancy.

When the US Government Peddled Subprime Mortgages

And with an apology for this lengthy but necessary introduction let us cite *The Wall Street Journal* (21/07, "FDIC Faces Mortgage Mess After Running Failed Bank" by Max Maremont): "It turns out that the US government itself was one of the lenders giving out high-interest, subprime mortgages, some of them predatory, according to government documents filed in federal court.

"The unusual situation, which is still bedevilling bank regulators, stems from the 2001 seizure by federal officials of Superior Bank FSB, then a national subprime lender based in Hinsdale, Ill. Rather than immediately shuttering or selling Superior, as it normally does with failed banks, the Federal Deposit Insurance Corp. continued to run the bank's subprime mortgage business for months as it looked for a buyer. With FDIC people supervising day-to-day operations, Superior funded more than 6,700 new subprime loans worth more than $550 million, according to federal mortgage data.

"The FDIC then sold a big chunk of the loans to another bank. The loan pool was afflicted by the same problems for which regulators have faulted the industry, inflated appraisals and poor verification of borrowers' incomes, according to a written report from a government-hired expert. The report said that many of the loans should never have been made in the first place.

"Hundreds of borrowers who took out Superior subprime loans on the FDIC's watch with initial interest rates higher than 12% – have lost their homes to foreclosure.

"Banking regulators are grappling with a new round of woes related to subprime mortgages, which were generally made to people with poor credit histories. This month, the FDIC took control of the IndyMac Bank, a major lender that specialized in higher risk loans, after it failed. The FDIC intends to keep IndyMac open, as it did with Superior, but it doesn't plan to originate any new mortgages.

"FDIC Chairman Sheila Bair has been unusually forthright in putting part of the blame of the mortgage mess on regulators, who she says should have acted earlier. But Ms. Bair – who took office in 2006, long after FDIC ran Superior – also has faulted lenders, criticizing them for 'lax lending standards,' making 'poorly underwritten' loans, and placing borrowers in 'products that create financial hardship rather than building wealth.'

"Some subprime loans have been blamed on lenders giving out mortgages for more than a house is worth, immediately putting the borrower in a financial hole."

"When FDIC learns a bank is about to fail, it tries to locate a buyer ahead of time to assume its deposits and loans. With Superior, the agency had little warning. A private-sector rescue plan had fallen apart at the last minute. The agency decided that the best way to maximize the value of the failed bank was to continue operating it under a new name while it searched for buyers.

"It continued to employ many of the bank's workers who originated subprime mortgage loans. The FDIC sold Superior's branches and its deposit-taking business for $52.4 million in late 2001, but no prospective buyers materialized for its subprime lending unit. The FDIC stopped funding the new loans early in 2002, and shuttered the operation by that May 31.

"Both before and after the FDIC takeover, Superior relied heavily on a national network of independent mortgage brokers to locate potential borrowers. Some such brokers have been criticized for focusing more on the fees they collect from generating loans than on the ability of borrowers to pay. In a deposition in May for the Beal Bank litigation, a senior FDIC official suggested that fixing the bank wasn't the agency's top priority. 'Our job was to go in and sell the assets of the institution, and not try to clean up the operations, per se to make this a better bank,' said the official, Gail Pateinas."

The Innocence of Government Staff

Clearly the staff around FDIC had not been enlightened about how special a place the Federal Reserve was, now that the debt of the federal government was the only legal tender of the land. "It is at crucial moments like that that the bill for burying our history is presented."

"Real Bank, based in Piano, Texas, sued the FDIC in 2002, not long after it finished paying the agency about $339 million for 5,315 Superior mortgages. Roughly half were 'New Superior' loans originated when the FDIC was in control, and half were underwritten by 'Old Superior.'

"Although the FDIC usually sells such loans on an as-is basis, the agency backed the Superior loans with extensive warranties about their quality, indicating that there was no fraud or misrepresentation in their origination.

"In its court filings, the Beal Bank claims that many of the loans weren't as represented by the FDIC. It says some were based on negligent or fraudulent appraisals, and others were based on false or inaccurate information about borrower income. It also says that minority borrowers were given loans with higher fees and interest rates that similarly situated white borrowers, in violation of federal law.

"The FDIC has established high standards of ethical and legal conduct for mortgages that it regulates, but has demonstrably failed to meet these standards in its lending activities at Superior and loan sales to Beal Bank,' says Andrew Sandler, an attorney at Skadden Arps Slate Meagher & plom LLP, who represent Beal Bank. 'This lawsuit is about requiring the FDIC to meet its own standards of accountability.'

"An internal FDIC legal memo on the case that was turned over to Beal Bank's lawyers refers to 'gross discrepancies' in some loan files, including forged signatures or 'wildly different signatures claiming when she to be that of the same person.' A single mother claimed two children in applying for a loan, but later cited the needs of five children when she failed to make a single payment, according to the memo which was undated."

Clearly this is hardly an environment that will raise the central bank to the dignity that will keep the credit and credibility of the state high enough above the water line to enable the central bank to dispense with a gold standard for buttressing its credibility.

William Krehm

Should Our Universities be Named as Co-defenders in the Subprime Pricing Trials?

Amongst the key evidence used by prosecutors in such trials would be articles that have begun appearing in *The New York Times* (20/06, "A Question of Price: A Debate Rages on How to Value Tricky Assets" by Louise Story). Similar debates have raged through the last two or three centuries among economists. To deal with issues so complex Adam Smith, for example, who tried to embrace the complex problems emerging before the industrial revolution, when the driving force in the change was the division of labour within factories rather than the industrialization introduced by Watts' energy-driven machines. In Smith's day the latter had still not replaced human muscles as the source of power in Britain's factories. But in addition to his labour theory of value – the amount of average labour – Smith knew that there were vital problems that required a different approach – and hence different value theories. Consequently when he was dealing with such other problems, he resorted to two other quite distinct theories of value.

One of these was the cost of production in which he examined the major cost groupings that employers had to meet: labour costs, raw material, financial costs.

And finally when he was concerned with the amount of labour the price of products would command he switched to the amount of "commanded labour" that could be associated with the prices of products. Let me note, in passing, that the latter has become of key importance in our dealing with competition from China and Asia in general. He was in fact on the trail of modern systems theory, but could not yet lay out the complex intertwining of the multiple causal factors that operate in a modern economy.

David Ricardo brought in the rent factor. He and his close friend the reverend R.T. Malthus, agreed to ignore the cost of labour, considering it a constant in terms of foodstuffs since the notorious prurience of the lower orders would always reduce wages to a survival level. So the one great variable factor – until the repeal of the laws on the import of grains in the Britain of their day – was the height of the tariff walls that determined the price of grain, potatoes and other foodstuff. This resulted in an unearned revenue for those who owned richer, more productive land than the average. And this awarded such landowners an unearned revenue. Even more strikingly this analytical construct was transferred to urban real estate, and in our day to the unearned incomes in the entire economy.

Up to the mid-19th century the working classes took little part in these grand debates of the great pioneer economists. Certainly, the labouring classes – mostly illiterate at the time – had little or no access to such swirling ideas. But early in the 19th century private mechanics institutes arose to teach workers how to read and write. Before that happened, discussions amongst economists had been much like frank discussions between husband and wife about local scandals after the kids had been put to bed. However, with the new literacy the youngsters remained very much awake. By the mid-19th century violent debates, if no t actual barricades arose in many of the European capitals. Especially after the Paris Commune (1871) a need arose for an economic theory that would shift the determinants of the distribution of the national income from the workshop to the market place: the concept of value was redefined as the degree of personal satisfaction that the consumer derived from a given commodity. Conceptually a discreet screen was lowered by respectable economists over what took place in the workshop. The consumer market was seen as determining value and just about everything else that counted. But there was an infinity of markets, depending to whom you entrusted the handling of tariff laws, social services, and much, much else. None of this received lasting attention, for the simple reason that the value theory in ascent merely reflected the political power conquered by the group whose class interests the officially recognized theory espoused.

The "Dominant Revenue"

That relationship was best summed up by the late French economist, François Perroux, who developed the notion of the "dominant revenue" – the income of that group in society that has conquered the political power that caused the welfare of society as a whole to be identified with the revenue of a specific class. Up to repeal of the *Corn Law* in 1843, it had been the revenue of large landowners, then it became that of the industrial capitalists, and then it was taken over by the national financial sectors.

And more recently the world financial sector.

In Britain, I know of a wise lady who had taught economics at one of the less celebrated British universities, while writing fine books on money creation as according to the views of the Social Credit movement, but now happily retired. Discussing her teaching experience at the university, she got the process right. "I would tell my students, if you get this question on your examination paper, you must answer it so and so. In fact it is not so, but if you give the right answer you will fail the examination, and that will not do you any good.'

Clearly, the economics departments of our universities should be in the dock as well for even more basic reasons.

Let me quote from *The New York Times* (20/6, "A Question of Price. A Debate Rages on How to Value Tricky Assets" by Louise Story): "How much is your investment worth? That might seem like a simple question on Wall Street, where the price of everything from Apple to zinc, flickers across computer screens every day. But inside Bear Stearns, the answer was anything but clear last spring for investors who put their money into two giant, and ultimately doomed, hedge funds.

"Two executives who oversaw the funds, Ralph Cioffi and Matthew Tannin, did not disclose that the funds were plunging in value until it was too late, the authorities say. On Thursday morning, the pair surrendered to federal agents and were charged with nine counts of securities, mail and wire fraud.

"Whatever the outcome, the case spotlights one of the most vexing problems confronting Wall Street as the credit crisis plays out. How to value tricky investments linked to subprime mortgages and other risky debt.

"As the mortgage market melted down last spring, Mr. Cioffi valued one of his funds as having lost 6.5 percent in April. But colleagues at Bear placed far lower values on investments in that fund. They said it had lost 18.97 percent.

"'It's a humongous problem for Wall

Street,' said Michael Young, an attorney with Willkie Farr & Gallagher. 'These days these valuation obstacles are at the core of the write-downs.'

"Mr. Cioffi and Mr. Tannin are the first Wall Street executives to face criminal charges linked to the credit mess. But many other bank executives are grappling with far bigger financial worries. Worldwide, banks have written down the value of assets by $380 billion, as high-flying markets have crashed back to Earth. Some banks hold that the write-downs have been conservative and that some assets may be written back up in the future. Others say the bill will keep mounting.

"Bankers like to say that valuing complex investments is part art and part science, but four large firms have said recently that some employees have not been honest."

But that is to belittle the problem. As

Warfare Supposedly to Bring Democracy Abroad, Brutalizes Government at Home

There is no need to cross a "t" or insert a comma in the summary of a touching article in *The New York Times* (12/07, "Immigrants Find Solace After Storm of Arrests" by Samuel G. Freedman): "Postville, Iowa – Back in 2002, before all the trouble, the Rev. Paul Ouderkirk retired from St. Bridget's Roman Catholic Church here, his last station in 43 years of ministry. He built a home 35 miles away along the Mississippi, and he indulged a passion for family history, tracing an ancestor who had arrived in New Amsterdam with the Dutch East India Company.

"Once a month or so, Father Ouderkirk drove back to St. Bridget's to officiate at a wedding or baptize a baby. He savored these rituals. proof that the Hispanic immigrants who had arrived over the past decade to work in Postville's kosher-meat plant were setting down roots.

"Then came the morning of May 12, when both satisfaction and retirement ended for the 75-year-old priest. Federal immigration agents raided the Agriprocssor factory, arresting nearly 400 workers men, for being in the United States illegally. Within minutes of the raid, with surveillance helicopters buzzing about the leafy streets, the wives and children of Mexican and Guatemalan families began trickling into St. Bridget's Church, the safest place they knew.

"It was about that time, with several dozen cowering people inside the church, when Sister Mary McCauley, the pastor administrator at St. Bridget's, found out that Father Ouderkirk was attending a ceremony for diocesan priests nearly two hours away in Dubuque. Unable to reach him directly, she left a simple, urgent message: 'We need to see a collar here.'

"By the time Father Ouderkirk extricated himself and reached Postville in the evening, nearly 400 families, some of them not even Catholic, filled the rotunda and social hall of St. Bridget's. They occupied every pew, every aisle, every folding chair, every inch of floor. Children clutched mothers. One girl shook uncontrollably.

"A few volunteers from the old Postville descendants of the Irish and Norwegian immigrants who settled here more than a century ago, set out food. Others took turns standing watch at the church door, as if the sight of an Anglo might somehow dissuade the feared Migra, as the immigrants call Immigration and Customs Enforcement, from invading their sanctuary.

"Already members of the church staff and a Spanish teacher from as nearby college were compiling the names of the detained workers. Father Ouderkirk conducted his own version of a census in this predominantly Hispanic parish. Gone were all but two members of the choir he had assembled over the years. Gone were all but one of the altar-servers. Gone were the husbands from the weddings he had performed, and gone were the fathers of the children he had baptized.

"As for the mothers, many of them also worked at Agriprocessors and had been arrested. In a putative show of compassion, federal authorities released them after putting an electronic homing device on each woman's ankle to monitor her whereabouts. These mothers were, in the new lexicon of Postville, 'las personas con brazalete,' the people with a bracelet.

"During his earlier tenure at parishes in North Texas and Marshalltown, Iowa, Father Ourderkirk had experience immigration raids twice, but never on this scale. By the second day, he had moved back into his bedroom in the rectory.

"'It's like God saying, "I gave you a little practice, because this is the worst,"' Father Ouderkirk said in an interview late last month at St. Bridget's. 'This has happened after 10 years of stable living. These people were in school. They were achieving. It has ripped the heart out of the community. Probably every child I baptized has been affected.'

"The only redemptive thing that can be said, perhaps, is that in the crisis of Postville – with nearly 400 immigrants imprisoned and facing deportation, with 40 mothers under house arrest, awaiting their own court dates, with families that had two workers now forced to survive on handouts from a food pantry – the beacon of the Roman Catholic Church to immigrants has rarely shone more brilliantly.

"'I came to the church because I feel safe here,' said Irma Lopez, mother of a 2-year-old daughter, who was arrested along with her husband, Marcelo, after they had worked at Agriprocessors for six years.

"At a practical level, Father Ouderkirk has hired four temporary staff members to help track the court cases and distribute food and financial aid to the affected families. Along with other religious leaders around Iowa, he had been preparing for a march of immigrants' rights. St. Bridget's parish, which has about 350 members, is spending $500,000 in the relief effort, he said.

"One month after the raid, St. Bridget's held a Mass in remembrance of the detainees. The name of every one was recited from the altar, and after every 20 names, a candle was lighted, usually by a *persona con brazalete*. The candles, half-burned, remain in the nave, beneath a wood carving of the Virgin Mother, each one an offering for a miracle.

"I pray to God for the opportunity to stay in this country so my daughter can be educated here,' Mrs. Lopez said. 'That was my dream.' Judgment of a different sort, though has been visited on Father Ouderkirk and his aides. One anonymous phone message warned him. 'What you're doing is against the law. Harboring criminals.' Sister Mary received an unsigned letter stating. 'May you rot in hell.'

"It is infuriating for Father Ouderkirk and his staff to hear from such nativists. St. Bridget's Spanish-speaking lay pastor, Paul Real, has forebears who settled what is now New Mexico in the 1500s. Like Sister Mary says, 'Once you've cried for two straight weeks, you don't have any more tears. But it doesn't mean you stopped feeling.'"■

banks have been deregulated and globalized to go on growing at the rate they have been alleged to grow. Derivatives – ever higher powers of acceleration – have been brought in to justify blown-up estimates of future growth rates. These cannot be justified by the alleged present rates of growth and incorporating the drastically higher rates of growth *acceleration* employing derivatives of various forms. However, the future in which this is to take place can only come bristling with unpleasant surprises, if only because our environment is already severely strained and damaged by the human encroachment already suffered.

The part "science" that bankers are quoted as attributing to the art of evaluating complex investments is not partly, but wholly bogus. The mathematical device of calculus supposed to bring some science into the picture, if only in a partial way, is simply not able to do that. The factual or empirical input of any mathematical tool is nil. Mathematics provide powerful tools of analysis, but in themselves have zero factual content. That must be fed them, and if the fare to which the mathematics applied does not correspond to the reality of the problem, the result is doomed to be misleading nonsense leading to catastrophic results.

Moreover, the technique of integration and derivation is based – one the reverse of the other – on ignoring second order growth rates, on the ground that those second rates are so infinitesimally tiny that you can ignore their second – and higher rates of growth. How then could you deduce anything – including derivatives of future growth by calculus from the current growth of ever more gigantic international banks into which future growth rates, moreover, has been worked with the mathematics of exponential growth? "Exponential" which otherwise educated folk who are not economists take to mean "very, very big." That is an infinite understatement. It refers to a mathematical expression set up so that the growth rate attained always equal the rate of increase of that rate. It is in fact the mathematics of the atomic bomb, which took a few seconds to explode over Hiroshima.

Obviously these are grounds for the prosecutors hauling the heads and accomplices of the economics department into court on charges hardly less grave than the two high executives from Bear Stearns have had to face. Unless you tackle the subprime investment problem at its real source, you are doomed to complicate the mess further.

William Krehm

The Final, Fatal Knot of Derivative-driven Equilibrium Economics

The Wall Street Journal (14/07, "Are the Hunters Low on Magic Bullets?" by E.S. Browning) comes up against the final absurdities to which ever-expanding equilibrium economics has driven this supposed science: "Despite repeated intervention by the Fed and central banks and regulators world-wide, no one seems to be able to prevent further damage to banks and other financial institutions. Shares of mortgage-finance giants Fannie Mae and Freddie Mac slid more than 45% last week alone. At week's end investors got a further jolt when California Bank IndyMac Bancorp Inc., a big mortgage lender with some $32 billion in assets, was seized by federal regulators.

"The Fed still has plenty of money to lend to ailing banks and other institutions. Investors expect that, if government-chartered Fannie Mae and Freddie Mac get into direr straits, the Fed and/or the Treasury Department will devise a program to keep them afloat.

"But the high-profile shock treatment that the Fed used last autumn and winter – most notably, a series of sharp interest-rate cuts – isn't readily available anymore. Since last summer, the Fed has knocked more than three percentage points off the target short-term lending rate, pushing it to 2% from 5.25%."

What is notable is that this is a situation that could not have arisen if two features of the great Rooseveltian banking reform had not only been undone and its very memory excised from the textbooks. Instead of relying on the Federal funds rate that sets – not the rate at which the Fed will actually lend money to banks in need, but the benchmark interest rate at which one bank will lend the other to meet its obligations to the Fed.

That is an important distinction, since during the Depression and again after the abandoning of the gold standard in 1971, the debt of the government to the Federal Reserve was the only legal tender on the land. And it was important that that not get mixed up with questionable assets that might end up with the Fed to support loans to the banks. That of course would bring the very legal tender under a cloud, which is in fact happening today for this and other causes that we will deal with.

There is a discount window where banks can actually borrow short term from the banks, but at a higher interest rate, but that would signal to the financial community that they are in serious trouble. That facility is in normal times rarely used.

What lessened the dependence on the Federal Fund rate, which has been used to flatten out the price level, due to an error in logic, that only a hopeless dunce would make in a logic course, but has been the very essence of equilibrium theory that was brought in over a hundred years ago. It is true, that other things being equal, if there is an excess of demand over supply, prices will tend to rise, and if there is a deficit of demand over supply, they will tend to droop. But propositions in logic cannot be flipped around and remain valid. If I hold a pistol to my head and pull the trigger, I will fall dead. But that doesn't mean that if a man drops dead, that he has necessarily shot himself. There are thousands of other valid reasons for people falling dead. But equilibrium economics works on the assumption that higher prices *mean* that there is an excess of demand.

You Cannot Flip Propositions Around and Take Them to Remain Valid

Let me mention only a few samples of the of higher prices that have nothing to do with an excess of demand over supply. Nobody but a fool on moving from a town of 20 thousand to New York, will expect his living costs to remain the same. How, then, can we expect flat prices to prevail when humanity makes such a move? Life spans are increasing in many parts of the world. That requires more health services, many of which only governments can supply. Our modern technologies require a far more educated population that was the case a couple of generations ago. That requires an ever greater investment in education, which constitutes a public investment. Indeed, in the 1960s, on the basis of the forecasts of hundreds of economists sent by Washington to predict the length of time it would take Japan and Germany to recover from the destruction of WWII. Theodore Schultz

in the 1960s was awarded Bank of Sweden Nobel prize from having concluded that the economists' forecasts were so wide of the mark because they concentrated on the physical destruction, and ignored the fact that the highly educated and trained work force of those two lands had come through the war essentially intact. He concluded that investments in human capital were the most productive a government can make. But of course, if it is treated as a current expense and written off in the year it is made, you come up with the wrong answer, and the bulk of that investment is written off as a current deficit and interest rates are driven up "to fight inflation."

A key feature of the Rooseveltian banking legislation that would have helped the Fed and other central banks out of their present quandary. Thousands of banks had closed their doors by the time Roosevelt was inaugurated for his first term in January 1933. One of the first things he did as President was to declare a bank moratorium which was renewed when it expired to prevent a continued run on the banks. When they finally reopened their doors the essence of the new banking legislation did not depend on the benchmark interest rate entirely to guide the economy. For interest is the basic income of banks and money-lenders, and giving it a monopoly in controlling the economy, lends itself to abuse. Two measures were provided under Roosevelt to prevent or at least to moderate the monopolist power that would otherwise result. in the hands of speculative capital.

Why the Statutory Reserves Were Crucial

The "statutory reserves" that required the banks to deposit with central bank a portion of the deposits they receive from the public, on which on which the central bank pays them no interest. By raising or lowering the proportion of the redeposits according to whether the economy required restraint or stimulus, this lessened the dependence on the federal funds rate. It also provided a safeguard against excessive power by the banks. The statutory reserves were reduced drastically in the US by being made interest-free only when banks were open for business. During the non-banking hours they were automatically shifted to interest-bearing accounts – and hence the statutory reserves rendered feeble. In Canada they were completely abolished between 1991 and 1993. Strange the leading business journal should not even mention them as being a tool in the Rooseveltian tool-kit to dealing with the problems that have overtaken the world banking system. Obviously if banks were kept out of acquiring stock markets, mortgages and insurance companies, they would not have access to the cash reserves that such "other financial pillars" need for their own businesses. Once the banks get their hands on them they use them as base money to which they apply the "bank multiplier" – the ratio of the near-money (i.e., is interest-bearing money) to the actual cash in their vaults.

But to fully appreciate the trouble that the world financial system is in we must move to another article on the same page of *WSJ* ("As Cost of Protecting Traders Hope to Turn Doubts Into Profits" by Liz Rappaport). "US Treasury Bonds are widely considered as close to a riskless investment as money can buy. But with financial woes mounting, some investors are betting they may profit from weighing an unthinkable question: Could the US government default?

"US Treasury bonds are triply-A-rated – the highest of ratings – and have American corporate and individual taxpayers behind them. So such an event is hard to imagine."

What is missing here is a mention of the

The Medium Is the Message

Carl Mortished in his column in *The Tines* of London informs us that "London has been gripped by anxiety over a spate of fatal stabbings of teenagers. A trend in the capital for members of criminal gangs to carry big knives has led to 19 deaths since the beginning of the year. Parents are frightened for their children and the Prime Minister, Gordon Brown, promises tough action, sentencing guidelines for knife crime are to be reviewed by government. And, not to be outdone, David Cameron, the Conservative Opposition leader, is demanding mandatory jail sentences for anyone carrying an illegal knife.

"This dangerous contraband is the sort of knife you might find in your kitchen, carried inside coats and through trouser belts by pathetic but dangerous and troubled youngsters. Overall, murder rates among the young are more or less unchanged – death by firearms is down but is compensated by a sharp rise in death from knives.

"That doesn't interest politicians on the stump as they rush to exhibit concern, arouse fear and urge the public to be vigilant and behave with civic fortitude. Politicians adopting Churchill-like postures as they warn about economic hardship and point to a vague threat – Islamic terrorists or knife-wielding teenagers. Parents are frightened for their children and the Prime Minister, Gordon Brown, promises tough action. And, not to be outdone, David Cameron, the Conservative Opposition leader, is demanding mandatory jail sentences for anyone carrying an illegal knife."

The air is full of menace, the specific nature of the threat is less important. It is the purest Marshall McLuhan: "The medium is the message." And if we seek beyond that message we arrive at a state of society that has little or less of the static tyrannies of yore.

Rather, what we have is a society where there is little that is static as was the case in feudalism or classical capitalism in which exploitation and inequalities were relatively known to the victims from birth to death, but today are constantly deepening and spreading at an ever greater and accelerating pace. Those more static models, no matter how bad, were known to the victims from childhood on. That left room for a belief in a compensation heaven for the virtuous after death. But not to the ever accelerating exploitation speed-up on a globalized, deregulated scale. Everything is new and ever-changing, and must remain so.

There is neither time, space, nor faith left for a peaceful, or even for ivy-covered alternatives even in crime and exploitation. There is then a common feature between criminal kitchen-knife wielding, Muslim or any other political or religious terrorism. It is the mating of the mathematics of the atomic bomb with the rate of financial expansion – a detached feature of the most abstract and ever-changing sort, with its compulsion to increase at the pace of the economic bomb and translated into the relationship gone screechingly wrong between man and his fellow man. It is time, indeed, to light a candle to the memory of the late Marshall McLuhan, not the least of the benign prophets, whose teaching detecting procedures that had barely begun to take over in his day, but have since come to format our fears, woes, and very existence.

William Krehm

fact that since 1971 the US is no longer on the gold standard, and that as a result the only legal tender in the land is precisely the debt of the federal government. But there is debt and debt. Behind the debt of the federal government is not only the taxation power, but the vast investments in physical infrastructures and other physical assets. These finally were recognized as assets, though significantly they are listed in the Department of Commerce statistics as "Savings" which they are not, of course, because savings signifies cash and the highest quality assets that can readily be transformed into cash. But what has not been recognized in the government's accountancy even as token values are investment in human capital – education, training, health, social services for which Theodore Schultz was briefly celebrated. Today both Schultz and his great principle have been deliberately erased from economists' memories. For that has been the fate of any economists that come up with insights that block rather than serve the ever growing power of our globalized and deregulated banks.

When we say, then, that the only legal tender is central government debt, we assume serious accountancy has been introduced into our government's books to distinguish between investments that will last even for generations, and appears as debt because it has been written off (or fully "depreciated") as a government assets in the year that it is paid for. Were it treated as capital, let alone as the most profitable investment a government can make, the books would have been in perfect shape, and instead of appearing as debt to mislead the electorate. We have long emphasized that the debt of the central bank which could provide near-interest-free financing of the government for its investments, is not really a debt but should be considered to have a positive rather than a negative sign before it. That can be simplified by recognizing once again what Schultz taught us in the 1960s – that investment in human capital – that would include not only education and training, but looking after the environment is an investment, not a luxury, and as such it should have a positive sign before it.

And then there is still a more shocking bit of tomfoolery that has replaced accountancy and economic logic that is playing a key role in the subprime banking crisis that has spun out of control. And, of course, it concerns derivatives in one of its most powerfully brainless forms, that we have warned against to no affect. Because of the deep distrust of the Fed's supposed solution of the banking crisis, doubting investment funds have placed bets through swaps that will increase in value as the mortgage investments they hold with trepidation shrink in value, with the market price of the mortgaged houses that are their security. There is no necessary relationship with the total value of the swaps and the value of the mortgage. It not only stands the economy on its head, but can actually shift the net interest of the investor to the value growth of the swaps. But there is also no assurance the counterparty of such a deal will be solvent and around when the swaps are called to bail out a trusting investor.

William Krehm

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What the Ordinary Guy must Know About the Different Kinds of Banking

To pick one's way through the complexities of bank history and of their present troubles both here and in the US and elsewhere in this globalized world, requires understanding some distinctions between banking here and in the US.

1. In Canada our small banks – the commercial banks as distinguished from investments banks, disappeared around two decades ago, shutting their doors or being taken over by the few large investment or general banks. This does not necessarily make our few large banks less prone to adventures than the small banks and trust companies that either went broke or were taken over by our big general banks. They are, however, more likely to be bailed out by the central bank and hence the government, if they get in serious trouble.

2. When the statutory reserves were abolished in Canada, they were only vastly weakened in the US. The statutory reserves were the percentage of the deposits that banks took in from the public that they had to redeposit with the central bank depending on what notice the original depositor had to give the bank when he wished to withdraw the deposit. Beyond that the central bank had the power to vary the percentage of the original bank deposit that had to be redeposited with the bank. This lessened the dependence of the central bank on benchmark interest rates set by the central bank that determined the overnight interest rate when one private bank borrowed from another to make up their shortfall in deposits with the central bank. What is important to note, is that the central bank avoided lending the money to the private banks itself, because that in a crisis could involve the liquidity of the bank – i.e., the legal tender of the land – if the banks got into serious trouble and came to the central bank to be bailed out. That is very much the case today.

The statutory reserves served another crucially important role. They ceased making the financial system entirely dependent on the benchmark interest rate, which is the primary revenue of speculative capital. With the abolition of the statutory reserves in Canada and a few other countries between 1991-3, the speculative finance sector took over our economy.

It is important to note that in the United States the statutory reserves were scaled down to a far lesser importance, but not done with entirely. That gives you the measure of the servility of the Brian Mulroney government of the day to American policymakers, and their desire to be holier than the financial pope of the day. In the US the statutory reserves continue but only during banking hours when they are placed in a non-interest-bearing account, but when the banks close their doors they are automatically shifted into interest-bearing accounts.

In the United States there are thousands of banks medium and small, as well as the

really large investment banks. These smaller banks are "commercial banks" whose borrowing from the Fed backs short term financing of commercial deals rather than long-term and speculative investments. In Canada that distinction between one and another of our large banks hardly exists.

For Canadian readers this may be important information to grasp the article in *The Wall Street Journal* (24/06, "Maybe It's Time To Put Banks and Wall Street Dealers Back Together" by Dennis K. Berman): "Investment banking kills. In the carnage of the Great Depression, Congress hoped to safeguard small investors by separating stock-touting investment banks from deposit-taking commercial ones.

"Now that it is clear that one small investment bank, Bear Stearns, had the potential for ruining the financial markets, the best way to protect the public may be the most ironic one of all: to push commercial and investment banks ever closer together."

Putting Commercial and Investment Banks Together

"The hope would be to absorb the volatile side of investment banks with more capital and stable deposit bases. Like burying a live bomb in a sand pit.

"Around Wall Street there is a rising, albeit reluctant acknowledgment this may be the best path for the likes of Merrill Lynch, Morgan Stanley and maybe even Goldman Sachs Group.

"Speculation has in recent weeks mounted that one of the Street's brokers may even buy a commercial bank. Whether true, the rumors speak to three deep changes under way.

"First, looming Federal Reserve assistance and regulation could force brokers to keep reserve rations similar to that of deposit-taking banks. Second, short-term funding now is regarded with suspicion. It is capable of being yanked at a moment's notice, sending a bank such as Bear Stearns to the brink of bankruptcy (it is now part of J.P. Morgan Chase). Third the securitization markets also have contracted, which in turn is forcing the investment banks to shrink their balance sheets.

"In theory these problems are all solved by putting a large plodding, typical bank – with stable deposits and returns – next to the speculative realms of investment banks and trading. But that would also bring investment banks closer to the Fed – the source of the country's legal tender.

"'Three or four years out, the investment-banking model is coming to an end,' says Brian J. Sterling, co-head of investment banking for boutique Sandler O'Neill & Partners. 'If it walks like a bank and quacks like a bank, it's going to have capital ratios like a bank.'

"Investment bank chiefs would do well to resist this change for as long as possible. The return on equity for an investment bank is typically 20%, while commercial banks generally deliver a mid-teen return. Why rush to cut your own profitability?

"The contrary answer would be to find the best partner possible before a rival snaps one up. Among the big commercial banks, troubled Wachovia is trading at slightly less than half its book value. The likes of PNC Financial Services Group may be attractive to a Wall Street firm looking for a steady deposit base. "During the stock market boom of the 1920s, one bank chief Charles Mitchell of National City (the precursor to Citigroup), rejoiced in 'bringing the investment banking house to the people…in a way that is part and parcel of their everyday life.'

"Today, the investment banks are so entwined with the every-day financial system that their problems belong to all of us, whether we like it or not."

We would suggest the careful study of the banking codes that were brought into the lives with investment banking to bring on the Depression of the 1930s, which in turn contributed greatly to give us WWII. And then for much of that time the world could kid itself that it was on the gold standard, and that pretense has long since has been dropped. Our only legal tended since 1971 has been central government debt. It is therefore awfully important for the ordinary citizen to know that his central bank and his legal tender has not become subprime.

William Krehm

Strands *from page 1*

the benchmark Fed Funds rate that that stimulated or restrained the economy. Now the subprime mortgage rates encroaching through the guessing game of the Fannie and Freddie bailouts is enthroning interest rates once again in absolute power as the dominant revenue of the land. That equips the world with a subprime currency system.

Obviously the only conclusion that can be drawn: is it is time to start dismantling the corrupt and ever more corrupting Globalization and Deregulation of our banking system?

William Krehm

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