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The Parable Coming In from All Sides

The parable coming in at from all sides is that it is impossible to run a world economy at an ever stepped-up speed and scope on a planet of limited resources. And even if you cook the books with fancy mathematics that just adds to the lethal mess.

Two items in the week's press reminded us of this, in quite disparate fields.

Steel Makers of the World Suddenly Distracted from Uniting into Bigger Corporations to Start Prospecting for Coal and Ore

The Wall Street Journal (20/06, "World's Steelmakers Go Prospecting" by Robert Guy Matthews) recounts: "Soaring raw-materials-costs are forcing the world's steelmakers to shift strategy. Now, rather than seeking merger partners in their own industry in hopes of gaining market clout, they are trying to protect their access to iron ore and coal by investing in mines.

"Steelmakers often owned their own mines in the industry's early days because few other companies had the capital to operate them. But in today's climate their goal is to lessen their dependence on big mining companies, whose steep price increases are squeezing steelmaking profits. The steelmakers' race for minerals, however, pits it directly against those mining giants who are equally eager to snap up any coal or iron ore deposits that go on the block.

"A consortium of Chinese steelmakers and China's sovereign wealth fund is entering the initial round of bidding for a stake in the iron-ore unit of Brazil's Companhia Siderurgica Nacional SA, people familiar with the situation said Thursday. The group's interest, though preliminary, shows the importance China places on securing supplies of ore and other natural resources amid the current commodities boom.

"Arcelor Mittal, the world's largest steelmaker, having recently purchased a series of iron ore mines in Africa, Canada and Russia and coal mines in Kazakhstan, India and South America, now touts itself as the world's fastest growing mining group." Last month it spent $631 million to buy a 14.9% stake in Australia's Macarthur Coal Ltd., the world's largest producer of pulverized coal, a type of coking coal used in steel making, thwarting the Swiss miner Xstrata PLC's plans to take over Macarthur.

"'Ensuring a reliable source of raw-material supply is more important than ever,' Lakshmi Mittal, chief executive of Arcelor-Mittal, said in an interview. The steelmaker, whose mines supply about 46% of its raw-materials needs, has set aside about $5 billion to buy enough of them to provide 70% of its needs by 2012.

"Since 2003, the steel industry has been swept up in a wave of consolidation, with steelmakers bulking up to feed the developing world's growing demand for bridges, buildings, power plants and other infrastructure. Among other deals, Arcelor SA of Luxembourg merged with Mittal Steel Co. of India and another Indian company, Tata Steel Ltd., merged with Britain's Corus Group. But now that wave is decelerating."

The Changing Structure of Steel

"Instead, steelmakers are plowing their profits into reducing their vulnerability to spikes in raw-materials prices. In the past year coal prices have more than doubled,

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A Gentler Spain Tries Forgiving Its Illegals

Globalization and Deregulation, rather than bringing a broader humanity into the world, only ruffled relations between man and his environment. It squeezed out the humanity built up over generations between consumers and the products they depended on. Strangely, none of this was foreseen when Globalization was sold us.

Now Spain is in the lonely forefront combating the massive influx of illegal immigrants with kindness. In these days of global deals, the obvious next step is likely shipping to Spain the Statue of Liberty that has welcomed generations of immigrants into the United States. Hopefully it will not be privatized en route.

The New York Times (10/06, "Spain, Grappling with Illegal Immigrants, Tries Forgiveness" by Jason DeParle) reports: "Madrid – With the United States riven by calls to legalize million of illegal immigrants, Americans might consider the possible effects by looking at southern Europe, where illegal immigration abounds and so have forgiveness plans.

"In the past two decades, Spain, Italy, Portugal and Greece have run at least 15 legalization programs, including a Spanish effort three years ago that was amongst the Continent's largest.

"With little domestic opposition, Spain legalized nearly 600,000 of the African, Latin American and eastern European workers who helped power its economy and brought this once insular land the strength and strains of diversity.

"Immigrants say their prized work cards have brought higher wages, peace of mind and reunions of separated families. But critics say legalizations have attracted more illegal migrants – with spillover effects to nearby countries – and warn that an economic slowdown now puts Spain and its foreigners at odds.

"Among the beneficiaries of the legalization policy are Ignacio Canto and Sandra Delgado, a husband and wife from Ecuador who left four children and an economic crisis in search of Spanish jobs. Legalization has raised their pay and ended their fear of the police, who once jailed Mr. Cantos for lacking work papers.

"It has also ended their separation from their youngest child, Allan, a gap-toothed 8-year-old sent with his siblings to live with their grandparents when he was 3. Since arriving in Madrid in March, he has been twirling his mother's earrings and stroking her hair as if worried that she is a mirage.

"'I would never leave my children a second time,' said Ms. Delgado, 38, a nanny who has been raising others' children while aching for her own. 'I'm sorry I did it.'

"Though both husband and wife favor legalization, they differ on the critics' main complaint – that regularizations attract more illegal migrants. 'I don't think so,' said Mr. Cantos, 43, a truck driver who argued that migrants moved out of desperation, not legal expectations. 'I didn't even know what a regularization was.'

"The United States has an estimated 12 million illegal immigrants, a record number. Its last mass amnesty program, which began in 1987, legalized 2.7 million. President Bush proposed an immigration plan that would give some workers a path to legalization. But it died last year under assault from people who said it would lead to more illegal immigration."

Yet, when Christ preached charity, he was not stopped by the notion that it would multiply the beggars.

An Aging Population Needs Immigrants

"Europe has held at least 20 legalizations in the past 25 years, giving residency papers to about four million people. Italy and Spain account for about two-thirds of the total, to the consternation of northern Europeans who see the south as the continent's weak back door. With free movement across much of Europe, legalized immigrants can easily head north, alarming those worried about job competition, welfare costs, cultural clashes or terrorist threats.

"Southern Europe's tolerance for illegal immigration has several explanations. Its aging populations and booming economies created a need for foreign workers. Its proximity to northern Africa and eastern Europe places it close to countries that supply them. And its economies have traditionally depended more on off-the-books workers.

"No country has run more legalization programs than Spain, which has carried out six since 1985. As recently as a decade ago, immigrants made up less than 2 percent of the population. Now they are more than 10 percent. About 40 percent come from eastern and northern Europe; 38 percent come from Latin America; and 20 percent from Africa.

"Despite the rapid change, until recently there was little political conflict, with legalizations occurring under both conservative and socialist governments. Spain even offers immigrants free health insurance, whether they are legal or not.

Attitudes Notceably Different than in the US

"'The attitude toward unauthorized migrants is much more relaxed than in the United States,' said Joaquin Arango, a sociologist at Complutense University in Madrid. The acceptance has been attributed to newfound prosperity, the need for workers, the progressive culture of post-Franco Spain and the shared language with Latin Americans, which spares Spain a major source of tension that exists in the United States.

"But with the economy slowing, attitudes appear to be changing. The unemployment rate among foreigners is now 14.7 percent, compared with 8.7 percent among Spaniards. Nearly 40 percent of the recent jump in unemployment has occurred among the foreign-born.

"People are starting to say, 'We don't need immigrants. They should return to their country,' said Sebastian Salinas, a lawyer with immigrant rights group Acobe.

"Immigration emerged as an election issue in Spain this year for the first time. Mariano Rajoy, a conservative challenger to Prime Minister Jose Luiz Rodriguez Zapatero, said the 2005 legalization had attracted more illegal immigrants and increased social tensions. 'We are heading towards a situation of enormous problems,' said Mr. Rajoy, who narrowly lost.

"Likewise, with Italy's economy faltering, Prime Minister Silvio Berlusconi recently promised a new crackdown on illegal immigrants. Mr. Cantos, in moving to Spain, traded one set of problems for another. One of 11 children born to poor farmers, he finished most of high school and landed a job collecting insurance premiums. But he lost it in 1999 when bank runs, a currency plunge and soaring unemployment sent hundreds of thousands of Ecuadorians to Spain, which they could enter without visas at the time.

"Mr. Cantos joined them in 2001 after borrowing the air fair in Los Angeles from a sister. (She had moved there illegally and become legalized, but warned him that the border was now too dangerous to cross.) He found piecemeal work in Madrid passing out leaflets and Ms. Delgado, needing money, reluctantly followed.

"They lived in a two-bedroom apartment with seven other migrants. They went to work fearing arrest. Ms. Delgado had lived in Madrid for two years when Spain put into effect the legalization, which covered only migrants with jobs. Of the 570,000 successful applicants, two-thirds came from five countries. Ecuador (21 percent), Romania (17 percent), Morocco (13 percent) Colombia, and Bolivia (7 percent).

"The government argued that underground work reduces tax revenues and gives lawbreaking employers a competitive edge through lower labour costs. But officials say their main goal was social, not economic.

"'If you practice exclusion, you risk the future of your country,' said Jesus Caldera, who ran the program when he was labour minister. 'You risk terrorism, violence.'

"Still, there have been costs. The slowdown in construction has idled Mauricio Velasco from Ecuador. who now draws unemployment benefits. Jorge Salinas brought his mother from Bolivia, but she soon needed a kidney transplant, which the Spanish government provided without charge. His mother, Miriam Vaca, 70, now gets free dialysis treatment three times a week. 'The ambulance comes to greet me,' she said. 'Thy are very kind.'

"French, German and Dutch officials criticized the Spanish move, fearing an increase in illegal immigration that would cross their borders. Some domestic critics said the program also attracted illegal workers dwelling elsewhere in Europe.

"Lorenzo Cachon, a sociologist at Complutense University, analyzed the programs 'call effect' by studying municipal records. Most immigrants in Spain, legal or not, register with local government to obtain benefits like health insurance. Their numbers grew 20 percent this year after the program was announced compared with 3 percent before.

"'That means the maximum call effect is 17 percent,' he said. 'In practice, much of that growth came from migrants already living in Spain, who registered as part of legalization. I consider that a small call effect.'

"A 2007 report by the Council of Europe, an organization of European states, concluded that the Spanish program may have had a small call effect. A 2007 report by the Council of Europe, an organization of European states, concluded that the Spanish program may have a small 'pull effect' but called it a 'positive experience from which many European states can learn.' For the Cantos family, the program brought an uphill fight. Mr. Cantos paid $1,200 to a lawyer who never filed his application, which he discovered only when stopped by the police. Finding him absent from the list of pending cases, they jailed him overnight and started deportation proceedings.

"Ms. Delgado did get her papers filed, only to discover that her employer failed to send them. She says her boss 'forgot' – drawing quotation marks with her fingers and rolling her eyes – 'because she knew I wanted to go back to Ecuador, and she didn't want me to go.' She won a long appeal, and Mr. Cantos was legalized as her spouse."

The Bonanza of Legalization

"Their combined income quickly rose about 30%, so employers had to pay more to keep them. With annual earnings of about $44,000, they make about 20 times what Mr. Cantos made in Ecuador as the family's sole provider. Mr. Cantos said legalization had brought him 'a sense of peace,' as he no longer feared arrest. But Ms. Delgado wears the willed smile of the woman trying to hide her sorrow. Her visit to Ecuador reminded her of how much she had missed of her children's lives.

"Their income allowed the couple to bring just one child to Spain, and they brought their youngest, Allan. Arriving in March, he found the weather cold, the food strange. Puzzled by his parents' fourth floor walk-up, he said, 'The houses are high.'

"Fearful of losing his mother again, he grows jealous when his father hugs her. He exploded one night when he heard his parents laughing in the next room.

"He ran out of the bathroom and said, 'You two are happier without me!' He still asks to this day, 'Why did you leave us behind!'"

As politicians reshape the world, deep unsuspected dramas are created that few authors could have dreamt up. That goes even for the pre-successful restructuring of the world to new designs across oceans.

K.

RENEW TODAY!
(SEE PAGE 2)

The Puzzle of Immigrant-friendly and Immigrant-unfriendly Nations

Elsewhere in this issue we deal with the policies of the leftist Spanish government handling the immigrants flocking into Spain from just about every point of the compass. In part this is due to the fact that Spain has need of immigrants since its own economy until quite recently was expanding briskly, and there were few native Spaniards or even legal immigrants available to do the least attractive menial jobs. But more than that is involved.

There are central nations with a great tradition of emigration, that seem just to lack empathy with immigrants. Germans and Italians themselves have emigrated to many parts of the world but seem to have little feeling for immigrants.

Despite their need for them to look after a rapidly aging population, to the Germans an immigrant is likely always to remain a *Gastarbeiter*, who, sooner or later, is expected to go home. But if there ever was an emigrant population it was the Italians – right from Roman times. The extent of Romance tongues from Romania to Portugal across Europe makes that clear. Emigration took place in a variety of forms from massive permanent emigrants to North America – who a couple of generations ago from those weeping on departing vessels in Naples and other ports bidding farewell to families they never expected to see again in this lifetime – to many of the gangsters in the US under Prohibition.

And yet immigrants into Italy encounter very little hospitality. Legal residence and citizenship is doled out with niggardly hand. And the United States, the classic land of mass immigration is actually building walls to keep immigrants out, as acutely needed as they may be for work that native Americans do not wish to do.

The New York Times (21/06, "Italian Plan to Deal with Migrants Affect Residents Who Rely on Them" by Elizabeth Povoledo) tells an incongruous tale: "Rome – It is an everyday symbol, touching almost, of Italy's troubled demographics: an older Italian out for some air, at times arm in arm with an immigrant aide. The aides often are not here legally but have been tolerated because they do work few Italians do: care for the nation's rapidly aging population.

"But much as Italy is growing, it is also worried about crime. And in the eyes of many Italians, for whom immigration is a relatively new phenomenon, immigrants also have a central role in this. Under a law proposed by the far right wing of Prime Minister Silvio Berlusconi's new government, it would become a felony offense to come to Italy illegally, punishable by prison.

"'These days on the streets, you see a lot of policemen, sometimes in plain clothes, stopping people and demanding their documents,' said Pilar, 31, a Peruvian here illegally who takes care of a 76-year-old Italian woman. She would not give her full name for fear of being deported.

"The law would be one of the strictest in Europe – and the proposal has drawn strong opposition from center-left political parties, human rights organizations, the Vatican, the United Nations, and Italian prosecutors worried about overwhelmed courts.

"Around Europe, the mood is not friendly towards immigrants: this week the European Union Parliament voted to allow illegal immigrants to be held in detention centers for up to 18 months pending deportation. Expelled immigrants who defy the order to leave can be banned from reentering the European Union for up to five years."

Friendliness to Immigrants a Political Hot Potato

"Experts say these restrictions are ultimately aimed at deportation. Italy would go a crucial step further, making it a prosecutable crime to enter the nation without papers – something that Mr. Berlusconi himself does not seem to like. He recently ventured that it might be 'unrealistic' for the state to jail perhaps hundreds of thousands of illegal immigrants.

"But he was careful to say that this was 'only a personal opinion,' because he is not willing to take on the bill's sponsors: the Northern League, an allied party that once advocated secession of Italy's prosperous north. More to the point: it brought down Mr. Berlusconi's first government in 1994.

"The law, part of a broad anti-crime package being discussed in Parliament, would in theory apply to all illegal immigrants here. But experts say it is particularly problematic as it relates to the illegal immigrants who care, in increasing numbers for the nation's older citizens. The reason is that Italians have constructed an informal do-it-yourself welfare system that preserves the importance of the Italian family by bringing aides into houses rather than shipping aged parents to nursing homes.

"In Italy, where life expectancy is increasing and the birthrate is among the world's lowest, the market for foreign home care aides is expected to swell. Istat, the Italian statistics agency, predicts that in 10 years 13.4 million Italians – nearly a quarter of the population – will be 65 or older.

"Domenico Volpi, 82, a retired expert in children's literature who keeps busy writing essays and textbooks, said he would be lost without Brigida Parales, who moved here from Ecuador eight years ago. She cooks his meals, cleans his house, reminds him to take his medicine and keeps him company.

"Ms. Parales is one of the few legal aides. Human rights experts fear that if the new law is passed, employers will not want to deal with the hassle of legalizing their help and may decide that their aides are imminently disposable.

W.K.

Reforming Economics — Ten Quick Steps towards Reality Economics

Some of the historical support for what follows is found in The Essentials of Capitalism Through Definitions: From Adam Smith to the Present Day: *http://economics.uwaterloo.ca/needhdata/CapitalismsEssentialsREV4.pdf.*

Mainstream economics was an *invention*. The major *entrepreneurs* contributing to "the theory" have long ago confessed that what they created was of bad design, inadequate and wrong. More than a few have said that economists have to go back to what Adam Smith, and others, really said about the system. Economists have to be concerned about economic and political power of the many visible hands that Smith discussed and not the mad-metaphor of an invisible hand.

Economic realists were doubters and disbelievers in the mainstream project long before the *entrepreneur's confessions*. A list of descriptions of mainstream or neo-classical economics includes: "a joke," "hot air," "witchcraft," "a para-science," "little boys' sandbox games," "lacks vision," "autistic," and "truth distortion." A reformed economics sets out to avoid such descriptors. Economics administrators ought not to leave a scientific legacy of econometrics, statistics and mathematical economics none of which can go anywhere without adequate interpretations of systemic realities to fuel inquiry.

An Economics Professor's Thoughts on the Curriculum

The *post-autistic economics* movement has contributed much to solidifying doubt and disbelief in the mainstream, and has assisted in making *the death of economics* a popular topic. All suggestions for reform involve getting beyond free market god worship. Nevertheless, the business managers in charge of the discipline, and many in charge of economic policy at federal and provincial levels, with little interest in disturbing feathered nests, and probably not knowing what to do anyway, seem to hang on to past litanies of the orthodox faith that run in terms of leaving it to the market to solve all problems. This seems like avoidance of the truth that the system is dysfunctional. Moreover, truth avoidance confounds the historical big-picture project of the University. Upper level administrators seem complicit for they quickly surrender to the immediate "faddishness" of globalization, internationalization of operations, trade and even entrepreneurship. And so the discipline and the university are in the saddest of states and much in need of reform. And the market doesn't help progressive reform at all; it wasn't designed to foster social responsibility – the market's businesses shirk social responsibility.

What follows is a suggestion for a quick way to change what is done in socially responsible ways. Overall the suggestion is to deal explicitly with Social Costs in *all courses* beginning with the introductory elements dealt with in both Micro and Macro – through to courses in graduate programs. Some of this is under way now.

But generally, even with an emphasis on systemically generated social costs mainstream economics requires systemic reforms along the following lines:

1. Fulfill the obligation *we have* to discuss and make known the United Nations Universal Declaration of Human Rights. Economic matters are central in the Declaration's last few articles. One can go on to the related covenants. This is a matter of equality rights of citizenship at home and abroad. The citizen has to be front and centre; democracy is advanced with the advance of human rights.

2. Be sure to always deal with factual reality along side the truth/untruth of mainstream theory. Since *reality* is different from mainstream theory one will finally be led to ask: Why hang onto a theory that doesn't explain anything but itself and that fails in its own logic anyway? J. Rawls – "…A theory however elegant and economical must be rejected or revised if it is untrue; likewise laws and institutions no matter how efficient and well-arranged must be reformed or abolished if they are unjust." (See S. Keen, B. Krehm.)

Capitalism as a Not-even-defined Given

3. Make the capitalist system the subject of investigation. Do not take the system as a *not even defined given*. In the sense of John Dewey, make the discipline of economics scientific. "The transition from an ordinary to a scientific attitude of mind coincides with ceasing to take certain things for granted and assuming a critical or inquiring and testing attitude." The work of P. Sweezy, C.B. MacPherson and S. Bowles and H. Gintis will assist in system definition and exploration in scientific terms.

4. Introduce power and institutional power in particular (power of the minority over others implies limiting freedom for otherwise equal citizens, the majority) as a unifying concept. (See J.K. Galbraith and R. Parker on Galbraith; also S. Marglin's, *What do Bosses Do?*)

5. Deal with law and property rights. Particularly use H. Glasbeek's *Wealth by Stealth: Corporate Crime, Corporate Law and the Perversion of Democracy*. Written by a corporate lawyer and Professor of Corporate Law at Osgoode Hall, Glasbeek's book should be of particular relevance in dealing with reality in courses in Industrial Organization. But no restrictions should apply; simply make it required reading. Glasbeek's book can be used at all levels.

6. Introduce pricing through markups on costs. Generally, prices are administered to all markets with demand determining supply and supply costs determining prices. While this generalization is close to reality, in some cases, however, prices are set, *customized to the customer,* without any reference to costs. The aim is to extract the largest incomes as possible from unsuspecting consumers who are kept ignorant of what is happening to them. The markup then falls out after the fact on each order that is placed.

7. Dispense with diminishing returns (at least put it on a hot back burner). Instead put increasing returns and declining average costs up front. Joined with power and administered prices competition quickly disappears as "capitalists eat capitalists" and force a private inter-sectoral and indeed international collectivization of industry. This is real *economic power in motion* and it is the on-going or evolving reality that everyone faces. (See the discussion of Schumpeter and McCluhan in *Profit as the Root of All Evil.*) Is it any wonder that unemployment, poverty, homelessness, environmental destruction, deaths in the work place, etc., are systemic social costs calling for *education, agitation and legislation*, to reform the system. Economics and economists can and should lead

in contributing to that reform – but the mainstream seems to cower with collective heads in the sand.

8. Take scarcity as primarily a concept relevant to an inadequate distribution of income for many. That is, *scarcity* means scarcity of commodities for those for whom their poverty is systemically explained. This is related to all of the above through gross inequalities in the distribution of income. This is perhaps the point at which one should introduce the idea of providing income to all as a right of citizenship thus stripping the normal mainstream tie between income and work. A universal basic income (UBI) puts the citizen at the heart of public policy and the extension of democracy and freedom.

Institutions that Drain Income from the Weaker

9. Introduce institutions such as banking, finance, and insurance as devices that assist in the systematic drain of income from the weaker to the more powerful. In this connection deal with slavery, wage slavery, debt slavery. Slavery required abolition (though still incomplete). The "system" ostensibly replaces personal slavery by wage slavery and debt slavery. Upton Sinclair has said: "The private control of credit is the modern form of slavery." (See Rowbotham.)

10. Into the above the full range of social costs (major costs already noted) may be inserted and elaborated as items that the system tries to escape by shifting responsibility onto individuals, communities, and generally onto society's shoulders. (See K.W. Kapp.)

A Social Costs approach to the delivery of economics will allow complementary links to other areas in Faculties of Arts, Environmental Studies, Engineering and the Sciences and implies a policy and applied economics emphases with easy links to the broader community. And as above, it also will mean a start at a relevant link between law and economics.

But there are other reasons why one ought to stress social costs.

So long as *corporatist governance in competition with democracy* is not recognized and not put up front Economics departments intellectually, in effect, and however implicitly, will be *saying that capitalism as fascism* is a given and is not a problem. It would be difficult to be more out of touch with reality and a "scientific attitude of mind."

That capitalism is *the problem* (whether or not one can stomach the reality of fascism as capitalism) is an inconvenient truth. The fascist fact is not at all contentious for many academics. Some seem happy to be complicit in its embrace.

But the fascist label will be a problem (at least one might hope it would) for the managers of universities who have succumbed to corporate lures in some fashion or another. Some, thinking that there is nothing that can be done, will merely shrug and shirk their larger social responsibilities.

And so it goes.

The attached bibliography provides more extensive support for the line of argument presented here. It ought to be more generally useful.

W. Robert Needham
University of Waterloo

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Hedge Funds at Cross Roads

We must apologize for the frequency with which we carry items on hedge funds. But consider them to be well en route to becoming the effective monarchs of the land. For years – without the public having the vaguest suspicion of the transfer of power involved – little was heard about hedge funds since the memorable bust of Long Term in 1999, In recent years even mentioning them without due bows and reticences came to verge upon *lèse majesté.* At a Cambridge University conference some two or three years ago, at a plenary session with three experts on derivatives on stage, I, from the audience, asked whether derivatives should be controlled. I might have asked that of William the Conqueror by the embarrassed silence that ensued. The evasive reply of the three experts – all in a way critical of derivatives which play a key role in the spurious risk-control that is the trademark of such hedge funds – went so far as to say they are not likely to be controlled, and rambled on until I had to remind them that my question was not whether they will be controlled but *should* they be controlled. I could not elicit a reply to that irreverent question. Studied and answered, it might have prevented the contorted anguish that our subprime debt system is finding it so difficult to overcome.

And now the business press is brimming with the trials hedge fund breed. Let us take the front page spread in *The Wall Street Journal* (17/06, "Shakeout Roils Hedge Fund World" by Gregory Zuckerman): "The hedge-fund business – among the most reliable fortune-producing machines in recent years – is going through a brutal shakeout.

"Just a few years ago, traders found it relatively easy to quit Wall Street jobs, hang out a hedge-fund shingle and cash in. Investors beat down the doors with eagerness reminiscent of the late-1900s dot-com frenzy. It took only a decade for the industry to grow to 8,000 funds from a few hundreds.

"But now smaller hedge funds, including top performers, are shuttering, and even brand-name traders are finding it tougher to get new ones off the ground. Only 1,152 new funds were launched in 2007, down almost 50% from a 2005 peak, according to Hedge Fund Research Inc. Because so many funds closed last year or merged into others, the business expanded by just 589 last year, the smallest increase in six years.

"The next test: the possibility of a wave of withdrawals at the end of this month, the next quarter date on which many investors are permitted to pull out their money. The inflow of new money from investors has already been slowing during the past two quarters. At the same time, hedge fund returns have been flat, adding to the pressure.

"Managers of hedge funds – private partnerships that cater to wealthy individuals and institutions and are less regulated than, say, mutual funds – like to think of themselves as a unique breed, capable of racking up big profits from opportunities that ordinary investors overlook. But in fact their profession is tracing the path of other businesses, whether autos or computers, that enjoyed rapid growth, led by aggressive entrepreneurs, before confronting deep challenges. And just as, say, eBay Inc. and Yahoo left rivals in the dust, or Vanguard Group and Fidelity Investments came to dominate the mutual-fund world, the largest hedge-funds, such as Och-Ziff Capital Management, D.E. Shaw & Co., and Paulson & Co. are pulling away from the pack.

K.

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Home Sweet Home Begun on the Return Trail

More than a half century ago John Maynard Keynes said it all in a few words: "We send Denmark our cookies, and they send us their cookies. Wouldn't it make more sense if we just exchanged recipes?"

Nor was he prepared to leave all to a free, deregulated and globalized market that would allow oil companies and transport companies and the banks to rake in a profit on anything that moves or stood still.

Meanwhile, the financial community dreams of a single globalized market on which anything that budges pays them tribute. However, in the actual real world, instead of a single factor, higher interest rates are supposed to keep prices as flat as a pool table, while profits move ever upward. But interest happens to be the basic revenue, the card-dealer and arm-breaker at all gaming tables. Those who brought in the globalized and deregulated market, simply assumed that removing custom barriers to trade would simplify things. In fact it has made them endlessly more complicated, and chockfull of brutal surprises.

Details of the phenomenon was given in *The Wall Street Journal* (13/06, "Stung by Soaring Transport Costs, Factories Bring Jobs Home Again" by Timothy Aeppel): "The rising costs of shipping everything from industrial-pump parts to lawn-mower batteries, to living-room sofas is forcing some manufacturers to bring production back to North America and freeze plans to send even more work overseas.

"'My cost of getting a shipping container here from China just keeps going up,' said Claude Hayes, president of the retail heating divisional DESA LLC. He says the cost has jumped about 15%, to about $5,300, since January and is set to increase again next month to $5,600.

"The privately held company, known for making the heaters that warm football players on the sidelines, recently moved most of its production back to Bowling Green, KY, from China. Mr. Hayes says the company was lucky to have held onto its manufacturing machinery. 'What looked like an albatross a year an a half ago,' he says, 'today looks like a pretty good asset.'

"The movement of factories to low-cost countries further and further away has been a bitter-sweet three-decade-long-story for the American economy, knocking workers out of good-paying manufacturing jobs even as it drove the prices for consumers. But after exploding over the past 10 years, that march has run into obstacles.

"The cost of shipping a standard, 40-foot container from Asia to the East coast had already tripled since 2000 and will double again as oil prices head to $200 a barrel, says Jeff Rubin, chief economist at CIBC World Markets in Toronto. He estimates that transportation costs are now the equivalent of a 9% tariff on goods coming into US ports, compared with the equivalent of only 3% when oil was selling for $20 a barrel in 2000."

Salute to Jerry Rubin for this key example that instead of seeing high interest rates the great smoother-out of the economy, translates oil prices into equivalent tariffs. He could have found another hundred or thousand equivalences of higher tariffs, rather than misreading, as establishment economists do, that interest raised high enough will keep our economy "free of inflation."

It is amazing how many truths suppressed in university courses have started seeping back in the columns of the better business press.

Distance Is Not Cheap

"'In a world of triple-digit oil prices, distance costs money,' Mr. Rubin wrote in a recent report. He figures that for every 10% increase in the distance of a trip, energy costs rise 4.5%.

"Transportation costs are just part of a larger wave of inflation sweeping global manufacturing, which has also been pounded by higher costs for basic materials such as steel and resins.

"The cost of doing business in China in particular has grown steadily as workers there demand higher wages and the government enforces environmental controls. China's currency has also appreciated against the dollar – though not as much as some critics contend it should, increasing the cost of its products in the US.

"Edward Zaninelli, vice president of trans-Pacific westbound trade in Orient Overseas Container Lines in San Ramon, Calif., a major shipping line, says he's heard from customers who are moving production back to the US, including the maker of steel pans for car engines.

"'I believe a decent amount of production could come back into the States within five years, not everything,' he says, 'but it won't be because of transport costs – it'll be because of other costs that have gone up and companies have realized they can have better control over their production when it's closer to home.' For many manufacturers, however, oil prices that have hurtled past $130 a barrel have been the tipping point….

"While many manufacturers are re-evaluating production strategies, there are limits to how many jobs will flow back to the US. One problem is that much of the basic infrastructure needed to support many industries – such as suppliers specializing in producing parts or repairing machines – have dwindled or disappeared.

"US job losses in manufacturing have averaged 41,000 a month so far this year – nearly double the pace last year, with sectors such as autos and construction materials especially hard hit.

"A prime example is Craftsmaster Furniture in Taylorsville, NC. The company two years bought back by as Chinese manufacturer, once intended to staff 40% of its US production in China by the end of this year or early next year. With the planned exodus about half done, it has stopped cold. As recently as a year ago, Mr. Roy Kalcain, the company president says he was saving 18% when he assembled sofas in North Carolina using kits of fabric pre-cut in China. Those savings are now down to 7 or 8%.

"The higher costs are particularly problematic for lower value goods: the cheaper the costs, the more significant transportation costs are in the final price. That may help explain why Chinese exports of such 'freight sensitive' Chinese goods are now failing for the first time in more in more than a decade.

"CIBC's Mr. Rubin predicts Mexico 'will be the biggest winner of all' as increased transportation costs make China uncompetitive in an ever growing list of businesses in North America. Even Mexico may be too far for some companies."

W.K.

Fingers to Nose, Hamburg Gives Naples Help with Its Trash

Even the name of Naples has come to be associated with overtones of slovenly neglect, but it comes from the Greek for "New City." and served as the capital of New Greece of Sicily and Southern Italy. It was the home of great emperors, poets and musicians, but their masterpieces became the property of the world at large, while the neglect and refuse stayed very much at home to clutter the Napolitan streets. The succession of foreign monarchs who succeeded one another – Normans, Saracens, Spanish Bourbons, added to the profusion of Naples' mostly neglected palaces. And not too far away Mount Vesuvius smokes on ominously and occasionally even lights up the horizon.

But it mattered little who occupied the Napolitan throne, the common folk had their living rooms on the street where the evidence of their fully lived lives can be measured by the heaps of garbage left behind.

Hamburg, in northern Germany, on the other hand is both a tidy and prosperous port in the German north. Now, however on a purely temporary basis. Hamburg is giving Naples a helping hand in coping with its garbage. *The New York Times* (09/06, "A Whiff of Naples Is Arriving in Hamburg" by Elizabeth Rosenthal) tells the story: "Hamburg – For months, mountains of rotting trash have grown in the Streets of southern Italy because the region has run out of places to put it For the time being – 11 weeks actually – a 56-car train will arrive in Hamburg every day after a 44-hour journey, each bearing 700 tons of Neapolitan refuse.

"'We are doing this because we were asked to provide emergency aid, but we will do this only for a few months, not years,' said Martin Mineur, the director of two of Hamburg's incinerators, as a steady stream of trucks carrying garbage from the train station roared by. 'Italy will have to solve Italy's problem.'

"But Italy's problem has echoes in all of Europe, where Naples looks increasingly like a foul-smelling version of an untenable past, and Hamburg its future. Despite population growth, Hamburg produces less garbage today than it did almost a decade ago. What it does generate is either recycled or removed to high-tech, low-polluting incinerators.

"Outside Naples, Europe's trash may not be overflowing in the streets, but across the continent, longstanding landfill sites are filling up quickly. The problem has made it imperative for European nations to cut their waste.

"By 2020, the European Union will require member nations to reduce the amount of trash sent to landfills to 35% of what it was in 1995. It has already begun severely restricting and reducing the use of landfills, a.k.a. garbage dumps, because of the host of health and environment problems they produce.

"But none of this will be easy. Italy, Spain, Greece and Britain each still send more than 60% of their garbage to landfills. A recent study found that they, as well as Ireland and France, are unlikely to meet these tong-term landfill targets. In 2006, the US sent 55% of its waste to landfills, according to Environmental Protection Agency.

"'Look, no one wants to ignore waste, or have huge piles of it out of sight in landfill as they do in Britain,' says Barbara Helferrich, a spokeswoman for the European Commission Environment Directorate. 'It's a difficult problem, but some countries are definitely much better than others in waste management.'"

Running Out of Landfills

"It is perhaps not surprising that Hamburg should take the lead. It is governed by the German Green Party. On the street pedestrians are required to divide trash into four types of bins, depending on its recycling potential.

"Germany and a few northern European countries have spent most of the last decade developing strategies to reduce and dispose of the waste generated by modern life: closing polluting landfills and investing heavily in recycling and trash reduction programs.

"For the trash that remains, they have developed state-of-the-art incinerators that minimize noxious emissions with a series of filters and have put the energy generated to good use by heating homes and water, for example.

"But incinerators take at least four years to build, officials here say. Getting permits and planning permits to deal with a smelly undesirable problem often takes longer. For instance, although German officials agreed in February to take trash from Naples, it took months to get permission for the trash trains from Naples to cross Austria.

"On Thursday, the trash transfer program was briefly suspended after Hamburg officials found a small amount of radioactive medical waste in one of the railroad cars; Italian officials promised better monitoring.

"But a number of countries have problems that will not wait. 'We have described the UK as the dustbin of Europe because we have put more to landfill than any other country of the EU, and our landfill space is running out very quickly,' said Nick Mann of the British Local Government Association. Waste in Britain is increasing 3% a year, and its dumps will be filled to capacity in nine years. Trash is really a hot issue.

"'Unfortunately, public concern about trash does not translate into solutions,' Ms. Helferrich said. Those depend more on the structure of government, management expertise and national priorities.

"Italy 'has money from the European Union,' Ms. Helferrich said. 'Italy has technical support, but they do not have a plan. Naples has not applied EU legislation, and they have been dragging their feet to come up with a proper solution.'

"In fact after years of warnings, the European Commission filed suit against Italy in early May, charging that it had failed to meet its obligation to collect and dispose of its garbage. Officials in Hamburg express a degree of sympathy, since until 2000 Hamburg sent a vast majority of its trash to landfills, too – most of it to the former East Germany. It was cheap and easy to truck away prosperous Hamburg's trash to poorer towns looking for hard currency.

"But a decade ago, the state environment minister decided to end the practice. 'After a while, they didn't want to take it, and we didn't want to export it,' said Reinhard Fiedler, who runs Hamburg's waste management. 'We had ambitious environmentalists and there was a lack of space for land fill.'

"The city of about 1.8 million produced 1.6 million tons of garbage a year in 1999, and only 50,000 tons went to recycling. Today, despite growing in size, it generates only 1.4 tons, 600,000 tons of it is incinerated, and 800,000 tons is recycled, said Volker Dumann, Hamburg's environment minister.

"The trend is to recycle more and incinerate less and to generate less waste altogether. Indeed, Hamburg's incinerators have excess capacity to accommodate Italian trash capacity because so much trash from the city is now recycled.

"Hamburg's incinerators not only dispose of trash, but also feed heat generated into the heating grid here. One plant here, run under contract by the Swedish energy giant Vattenfall, heats water for a large part of downtown Hamburg."

Disposing of Trash as Fuel

"So it was not surprising that when Italy had a garbage disposal problem, it turned to Germany for a solution. On February 28 a delegation from the Campania region which includes Naples, flew to Berlin to ask for help from Germany. Last year, as the crisis deepened, one German city, Bremerhaven, quietly took a small amount of Naples' trash for incineration. This year as the crisis deepened, it helped bring down the left-wing government. A larger rescue was needed.

"The German Environment Ministry agreed to take 200,000 tons of Naples' trash for incineration. Some states, like Hesse, which includes Frankfurt, refused to take Italian trash. But Hamburg said yes. Hamburg has three incinerators, one privately run by Vattenfal, one public and one a public-private partnership.

"Naples and a host of other countries and cities have long ignored trash problems that are hazardous and environmentally damaging. Landfills leach toxic chemicals into the ground and produce methane, a gas far more potent than CO_2 from car or factory emissions in terms of its effect on global warming.

"To reduce landfills' use, governments are encouraged to reuse, recycle and then incinerate if necessary. In the US the Environmental Protection Agency recommends a similar 'waste management hierarchy,' with landfills as the last option.

"While incineration does produce greenhouse gas in the form of CO_2, newer incinerators are relatively clean, using new technology to filter out heavy metals, nitrous oxides, particles and sulfites. In addition, Hamburg has placed its incinerators within the city, so that emissions from garbage truck transport are minimized and so that the heat from burning trash can be fed into the local heating grid. The Vattenfall plant is minutes from the city center, on an industrial road lined with recycling plants.

"Politicians in Naples said the region has been unable to build planned incinerators in Naples because of local opposition. But Guido Bertolaso is not buying that any more. 'As you drive around Europe, you see incinerators in lots of neighborhoods,' he says."

W.K.

Do We Need a Rating Agency to Rate Our Sub-prime Economic Theory?

From Washington, Barrie McKenna (*The Globe and Mail,* 06/10) reports: "US regulators have begun a sweeping overhaul of the way credit rating agencies do their work and get paid. amid concerns that cozy Wall Street ties exacerbated the mortgage meltdown.

"The US Securities and Exchange Commission is expected to unveil new rules at a meeting tomorrow in Washington, including new warning labels on complex 'structured' bonds, a possible ban on coaching issuers how to earn coveted triple A ratings, and enhanced transparency. The crackdown comes a week after New York Attorney General Andrew Cuomo reached an agreement with the three major rating agencies – Moody's Investor Service, Standard & Poor's, and Fitch Ratings – to shift toward a compensation system that would see investors and not security issuers, pay for ratings.

"The deal ends a state Investigation, without fines assessed. The companies will have to change the way they're paid for issuing ratings and co-operate with a continuing probe of other mortgage industry players.

"The reforms are a welcome response to a major crisis of confidence that has gripped the mortgage bond market since last summer. Bond raters held a pivotal role in the unfolding mess. As the market began to unravel, flawed ratings meant investors had no way of knowing the scope or location of the problem loans – precisely the scenario the ratings were designed to prevent.

"Triple-A-rated bonds were often backed by large numbers of risky subprime mortgages, making a mockery of the rating system.

"The potential for this disaster was clearly enhanced because rating agencies had too much incentive, and not enough disincentive, to play the role of unbiased arbiter of investment quality. Even sophisticated investors were badly misled."

"Too much incentive and not enough disincentive" rings not a bell but an alarm gong, for it fits like a glove the systematic cleansing not only of government officialdom, but of university economic theory teaching staffs of all that was learned during the Great Depression of the 1930s – about how the causes of the Depression of the 1930s that eventually brought on the world war, that closed down 9,000 US banks in the US, and caused Roosevelt to declare a bank moratorium, and bring in legislation that forbade the banks to acquire an interest in the other "financial pillars" – stock brokerages, insurance and real east mortgages. For what brought on the speculation of the 1920s and the 1929 crash was the banks' access to the cash funds that these other "financial pillars" needed for their own businesses. And using that as their cash base and applying the bank multiplier to it, they engaged in speculation that eventually brought the whole financial system crashing once again. It should be clear that, had the banks continued barred from acquiring mortgage companies, there would have been no subprime mortgages, and if they had continued restricted from acquiring insurance companies, there would be no need for the current investigation of subprime insurance and rating agencies.

But let us return to the newspaper report: "This year alone, the Big Three rating agencies have downgraded or put under review more than 20,000 mortgage bonds – many of them previously top-rated issues. The writedowns, often coming without warning, have been key trigger for nearly $400 billion (US) in losses by banks and securities dealers. A lengthy SEC investigation has uncovered an array of disturbing potential conflicts of interest."

Rating Agencies in a Wild West Setting

"For too long, rating agencies have operated in a Wild West environment. In the esoteric business of complex structured bonds, for example, the state investigation found that companies were virtually auctioning off triple-A ratings to the highest bidder. Ratings had become a commodity, rather than a service."

Whoa, can't everything be left to "the" market, according to the official economic dogma that has taken over the economics courses in our universities, and even our economic textbooks? Has it not corrupted government bookkeeping where investment in human capital – briefly recognized in the 1970s as the most productive investment a nation can make, being carried on the government books as a current expense and down-loaded without the money to finance education, health, and social security as the key investment. So we are building more prisons than schools, though the schools come far more cheaply and create investments handed down from generation to generation.

Again, should there not be an investigation of how such investments – carried on the books as a current expenditure – has prepared the way for the privatization of government infrastructure for a song? That is one of the great government bookkeeping scams that has fed the international stock markets with government assets acquired for a pittance to deal with misleading government deficits. It would lead to a fine for a false tax return if a private citizen declared a false value for his assets.

"At a recent US Congressional hearing SEC chairman Christopher Cox acknowledged that the SEC doesn't have the power to revoke a rating agency's license for shoddy or faulty ratings.

"The SEC is also looking at requiring rating agencies to disclose more information about the reliability of past ratings, keep their ratings up to date, resist gifts by the underwriters to agency employees, and require full release of bond information to rating agencies, whether or not they're getting paid. Of course, no amount of regulation can eradicate greed and stupidity.

"But as Mr. Cuomo, New York's Attorney General explained last week: The mortgage crisis is rooted in 'misrepresentation and misunderstanding of the true value of mortgage securities.

"The sooner regulators fix these structural and systemic flaws, the sooner investors can anticipate a return to healthy financial markets."

Not if we don't push these investigation further to examine why our government bureaucracy and our universities have buried all that was learned from the Great Depression, WWII, and a prosperous couple of decades of more democratic economic policy during a good couple of decades of the peace. Otherwise we will find ourselves at war with the environment, and the elementary principles of democracy.

William Krehm

Quality of Life and the Price of Gold

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

For those people fortunate to own a variety of stocks and some gold, and want to know what is going up or down, this news is exciting. The business section of newspapers offers even more information with many pages listing various stocks. The TSX, the NASDAQ, S&P and stock markets around the world are followed daily along with the price of gold and of oil (black gold). Do you feel better when you know the market is going up? Are you depressed when you note that the price of gold is down? Of course investors can win even when the price is down if they had bet correctly on the future. So everyone on the TV screen is smiling as the bells rings at the market closing each day. Of course it doesn't really ever close: buying and selling is a 24-hour per day, 365 days a year process thanks to the internet.

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

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

In Columbia the British gold mining company Anglo American has been accused of profiting from persecution, intimidation and killing of people opposing the mining. Army operations have benefited the mining companies as traditional small scale less polluting gold mining is replaced by big company exploration and extraction and the use of cyanide in the process. In South Africa at this moment over 2,000 gold miners are trapped underground. South Africa's gold and diamonds do not seem to have benefited most of the people.

So quality of life depends on whose quality of life one considers. It can go up with the acquisition of more gold or down for those who are robbed of their land or face the cleanup after the mine closes. Mining areas on forested mountain slopes cannot really be remediated.

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

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

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

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

One emerging big business is in bottled water. With no thought for the environmental consequences of millions of oil-based plastic containers being dumped, the public has reacted in opposition.

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

Of course most people would rather think about their own immediate concerns such as employment. And the press does give figures on unemployment and bankruptcies. More news on the causes of these trends would help us determine our own futures. What are the best types of jobs for those entering the job market? Why are some companies going bankrupt? Is there a global trend in unemployment and underemployment? Will our investments in the stock market help create jobs in poor countries or have they actually reduce the number of good jobs through downsizing to increase profits?

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

When the UN wanted to assess the condition of people around the world it produced Human Development Reports. These measured the following:

Life expectancy at birth,
Infant mortality rate,

Population with access to safe water,
Underweight children under age five,
Adult literacy rate,
Gross employment ratio for all levels,
Real Gross Domestic Product per capita,
Daily calorie supply per capita,
Infant and maternal mortality rate,
Female student rate, and
Women in government.

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

The report also relied on several measures such as the GDP and the GNP (Gross National Product), the means used by most countries to measure their economic progress. The GDP unfortunately also measures damage done to the environment as a positive product because it does involve work and materials.

The HDI report introduces several interesting indices: GINI coefficient, a measure of inequality in the distribution of landholdings, the GDI, a gender-related development index and the GEM, a measure of gender empowerment. These measures seldom make the newspapers. As workers around the world struggle to retain their plots of land and their way of life, surely the problems arising from the huge movement of landless people into mega cities of squalid poverty is newsworthy. It has yet to dawn on economists that living on $2 a day does not leave money for all the products our economy produces. When our customers are happy we should be happy. When our potential customers are poor we will suffer.

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

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

The empowerment of women and the resort to war are related as Dr. Mary-Wynne Ashford notes in her book, *Enough Blood Shed.* "There is always a gender gap on matters of war and defense. You'll find women less willing to go to war, less willing to spend on defense, and more attuned to health-care needs, educational needs, and childcare needs." (Zogby International pollsters). Our global war system is dominated by men. "Masculinity has always been an essential tool wielded in this many-pronged process of empire-building. At home it has been necessary to convince both men and women that a militarized manliness (especially one allied with a manly sort of reason and a manly brand of commercial competitiveness) was a superior form of humanity." Women are rising in power in governments but are, as yet, too few to change our policies. Many of our worst problems are caused

The Depth of Rot in the Judicial Overview of Wall Street

The New York Times (20/06, "Trade Now could Cost Broker Later" by Floyd Norris) can only be described as combining tongue-in-cheek with a winking eye in describing the Wall Street morality.

"Did you ever hear of a broker who would not agree to earn a commission? Even if getting the money required absolutely no work at all?

"Apparently, some brokers think such a move could be wise. It's not that they don't like income, but they may fear that letting some securities trade at low prices could force them to report even larger losses than they are already posting.

"The Financial Industry Regulatory Authority or Finra, put out a regulatory notice last week cautioning brokers that if a customer wants to place a sell order, the broker must execute the trade.

"Recently, questions have been raised regarding a firm's obligations when it receives a customer's unsolicited instruction to liquidate a position in an illiquid security when the customer is aware of specific buying interest in that security, the notice states. 'There is no Finra rule that would require a firm to refuse to follow the customer's instruction under these circumstances, even if the firm believes the market or price for the security is not favorable at that time.'

"Now it is a little unusual for any regulator to put out a statement saying there is no rule about something, unless some one claimed there was. It used to be that the only brokers accused of ignoring sell orders were the penny stock pump-and-dump operators, who did not want to let unfavoured customers sell out before the price collapsed. This time it is different. Penny stock firms do not execute trades in things like collateralized debt obligations. It is the major firms that do that – or refuse to do it.

"I can recall few times when so many on Wall Street have wanted to deny that market prices are justified. In public, they insist they have written down their securities to their best estimates of market value. In private, they argue that virtually all mortgages that are, or used to be, rated AAA will in the end meet all their obligations, but the panic and a lack of solid information on the details of each deal have led to ridiculously low prices.

"They may be right, of course. Markets do overshoot. If the firms being asked to execute orders in illiquid securities find the agreed-upon price to be an incredible bargain, they could offer to pay a higher price, and no doubt receive hearty thanks and enduring loyalty – from the selling customer.

"But the firms do not want to do that. The customer might tell his friends, producing more sell orders. In any case, Wall Street is busy pushing up its leverage by selling assets and raising capital from investors. Bloomberg News calculates that financial institutions around the world have raised $302 billion in capital – but taken $396 billion in losses – since the subprime crisis erupted.

"Richard S. Fuld Jr., the Lehman Brothers chief executive, assured investors in a conference call this week that the firm's $2.8 billion quarterly loss came after it wrote down everything to very conservative levels. But he added that having to take a loss that large was 'just totally unacceptable,' and he ousted Lehman's president and chief financial officer. Their successors are not likely to be eager to take on a lot of risks, and neither are their competitors."

W.K.

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

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

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

Many writers have referred to gold.

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

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

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

Shirley Farlinger

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The Industrial Revolution Invents Free Lunch

TINSTAAFL. "There is no such thing as a free lunch." For forty years that has been a favorite rejoinder to proponents of increased public effort to improve the common environment. It is touted as a fundamental, inescapable economic reality. For example, cleaning up the Great Lakes will eliminate the incomes of millions of workers in affected industries, or, we can't afford to fix deficiencies in medical care and fight off the "invasion" from Afghanistan at the same time. It is a pretty effective silencer, because we all understand that everything comes at a cost. On closer inspection, however, there is an implication embedded in the principle that may not always withstand scrutiny. It implies that the price of everything is a sum of legitimate costs. That is, when everyone who contributed to the product or service has been compensated for his goods or effort, the sum does not include any obvious surplus.

Skeptics are doubtful. When some get filthy rich while others work hard for a bare subsistence, it feeds suspicion that the lucky ones are riding a gravy train of some kind. The investigation of this possibility seems to be a domain primarily for amateurs. That is because the relevant professionals (police, lawyers, accountants and economists) have been generally complicit with the "no free lunch" sentiment. They might have doubts about its veracity, but it is bad for a young professional's career prospects if he or she shows too much interest in probing for the sources and nature of systemic slush. A relative few do nonetheless manage to get a career focus on the issue. Consequently, there is illumination if one looks beyond the daily business columns and the statements of politicians and pundits. One good example is correspondence between Michael Hudson and J.W. Smith that was published in *ER* last December under the title "Sectarian Frustrations to Economic Reform." It revisits the literature of *classical* economics and the emergence there in the early 19th century of the concept of *economic rent*. The definition provided is "that element of price that had no counterpart in actual costs of production."

The Villain Is Rent, Not Profit

It is important to distinguish this concept of *rent* from *profit*. It is quite common for laymen to make profit the focus of their indignation over inequities and distortions in the economic system. As economic analysis developed, however, *profit* came to have a special meaning as the justifiable return to the risk and uncertainty that an entrepreneur confronted when committing his capital and his time and energy to a business venture. There is no such justification for (economic) rent. It is a flow of income that comes to one purely because he has proprietary rights to a space, resource, or facility that is in high demand, meaning that willing buyers bid up its price. The metaphor of a tollgate was used in an illuminating speech by Michael Hudson, reported in *ER* of September 2006. For readers especially interested in banking reform, Hudson notes that grabbing every available (and remotely possible) *rent* is the aspiration that drives bankers to continually extend more credit. Pursuit of rent is what creates financial bubbles.

The phenomenon of rent was discovered at the outset of the Industrial Revolution. New methods, tools and institutional rules permitted higher productivity in agriculture, and the factory system stimulated urbanization. Together, these factors encouraged higher prices for land. David Ricardo gets most of the credit for first describing the increase in the price of simple space as a consequence of external events and influences. Rent became a standard element in *classical* economics. For a time it was accepted as a legitimate return to landowners, but as the phenomenon became more pronounced in its effects, John Stuart Mill began to call it an "unearned increment." A flood of trenchant criticism ensued, from Socialists (Fabians), Henry George, and especially Karl Marx. Classical economics had inadvertently become a threat to the proprietary claims of the wealthiest classes. (The exploitation of labor by the owner of a strategically situated factory was a slightly different but related phenomenon, but one that could be combined with rent in the sum of the capitalist's "ill-gotten gains.") This development called forth an effort to re-arrange economic analysis so that it no longer threatened the establishment. The successful reformulation is called *neoclassical* economics, and in its most extreme version it demonstrated (logically rather than empirically) that everyone's income was an accurate reflection of what he or she contributed to the collective wealth. (For a more complete exposition on this transformation in economics, see "Political Doctrine vs. Science in Economics" in the COMER articles archive for November, 2006.) That is why successfully indoctrinated economists can say smugly that "there's no free lunch" – to the great frustration of critics who know damn well that there is.

Recommended Reading: An Old Book

One of the best and easiest ways to get the flavor of how the idea of rent developed as a source of indignation and political agitation is to read a small book (Toynbee, Arnold, 1956, *The Industrial Revolution.* Boston: Beacon Press paperback edition, xiv+139 pp.) that that was written about it 125 years ago and which you can download free from Google. To my regret, it has been on my shelves for decades, unread or at least under-appreciated except for the curiosity of a preface written by Arnold J. Toynbee. The book title is *The Industrial Revolution* and it is the 1956 re-issue of the 1884 *Lectures on the Industrial Revolution in England.* The lectures were delivered at Oxford University in 1880-81 by a young historian who died in 1883 at age thirty. His name was Arnold Toynbee. The more famous historian was his nephew, named for him because he was the first male child of the same surname born to the immediate family after the death of the young author. The book of lectures was actually written after his death, by his friends and students, from his lecture notes

India and China Use an American Banking Invention that the US Itself has Abandoned

India has gigantic advantages in the economic development that is underway. There is a legal system modeled to an extent on that of the British Imperial of yore, of course, and powerful cultural traditions of its own, and a hungry mega-mass of workers available at rates that make corporations mouths' water. But its social problems are of similar magnitude.

And feeding an over-one-billion-headed population, living near the bare survival level, is bound to raise problems when throughout much of the world foodstuffs have been increasingly directed to feed gasoline-guzzling cars and other extravagant luxuries push the price of food, heating, transport and much else towards the skies.

Unfortunately the economic theory that India steers by – like that of much of the rest of the world has been operating with basic notions such as "inflation" that is applied to any upward movement of the price level. Now, it is true when there is too much demand and not enough products to satisfy it, prices will go up. And that is genuine inflation.

But in our ever more complicated world there are ever more other reasons for prices going up. And it doesn't help if you give the same name "inflation" to rising prices that may be due to not to an excess of demand over supply but to one of the other reasons. If I move from a town of ten thousand to New York, I would not be fool enough to expect my cost of living to remain the same. How then could it remain the same when much of humanity is making a similar move? And the infrastructures and new technologies needed to allow such cities to function require a population that has been educated and trained, not only in a few years of primary school as was the case a half century ago, but even to handle computers, which requires a bit of university training. That costs money that can only be provided by the state. That leads to the phenomenon of what I have called the "social lien."

But having repeated this word of caution about this misleading term "inflation," let us proceed with the excellent article in *The Wall Street Journal* (10/06, "India Likely to Try to Curb Inflation" by Jackie Range): "Amid soaring global fuel prices, India last week trimmed fuel subsidies, raising gasoline and diesel prices by about 10%, while also increasing the price of cooking fuel. Such measures are supposed to contribute to inflation, with wholesale-price inflation – the measure most watched in India – already at a 44-month high and forecast by analysts to hit 10% with a rise of 7.87% in March.

"Economists now say that it is likely that the Reserve Bank of India, the country's central bank will opt to either to increase the proportion of deposits [they take in from the public] banks must keep as cash reserves – a measure that tamps lending – or to raise interest rates."

The first-mentioned option is known as "statutory reserves," and was abolished in Canada by 1993. These reserves earn no interest for the banks and thus provide an interest-free loan to the government, apart from serving to rein in the amount of lending the banks can do. The reason for that provision is clear – if the banks earned interest on their statutory reserves it would deprive its leverage for the latter purpose. The statutory reserves would have to be raised or lowered much more to achieve the same effect.

It is thus an alternative to the benchmark rate of interest that the central bank sets for overnight lending bank to bank. Note that in the benchmark interest rates, the central bank up to the present crisis indicated what rate must be changed for overnight borrowing *bank to bank*, but did not provide the emergency loans to banks themselves. There is another emergency window at the central bank that does lend banks money in their need at a higher rate, but banks hesitate to use it. For when they do, the higher rate they are prepared to pay tips off the financial world that they are having money trouble – and that can start a run on the banks and results in their having to pay higher rates to everybody they deal with.

Now what is significant is that the other huge Asiatic economy – China – likewise makes use of the statutory deposit resource as does India. So we have at least two of the large up-and-coming rivals of the United States making use of the statutory reserve tool that the US has virtually done away with. It exists only during bank hours where the deposits are put in non-interest-paying accounts. When the banks close their doors such statutory reserves are automatically shifted to interest-paying accounts.

This utilization of a policy that was first developed in the US under Roosevelt, but has been largely abandoned by the US, merely indicates that in the US the autocracy of speculative capital has reached levels known in few other lands.

W.K.

and their own notes from their interactions with him. In the preface to my Beacon Press paperback edition, the nephew writes that "Toynbee was the first economic historian to think of and to set out to describe, the Industrial Revolution as a single great historical event, in which all the details come together to make an intelligible and significant picture. In doing this he created the frame in which all subsequent work on the Industrial Revolution has been carried out."

It seems a bit surprising that a focus on that revolution should have taken so long to be noticed by historians. It seems to be so, nonetheless. Wikipedia says that "[Toynbee's] lectures on the history of the Industrial Revolution in 18th and 19th century Britain proved widely influential; in fact, Toynbee coined, or at least effectively popularized, the term "Industrial Revolution" in the Anglophone world – in Germany and elsewhere it had been brought into circulation earlier by Friedrich Engels, also under the impression of the industrial changes in Britain." An ambitious work on origins of the idea was written in 1989 by Donald Cuthbert Coleman: *Myth, History, and the Industrial Revolution* and he found much earlier origins – but not in Britain. He says the phrase "révolution industrielle" appeared in France as early as 1827. In 1837 a French economist, Jerome Adolphe Blanqui (not the famous radical socialist, Auguste) noted that England was in the grip of a "révolution industrielle." In 1839 a two-volume book about industry in Belgium had a chapter entitled "Révolution industrielle" and identified 1770-80 as the time when it manifested a clear character in England. Such usages, says Coleman, presumably enabled Engels, in opening lines of *The Condition of the Working Class* (1844) to say that it was well known that textile inventions plus the steam engine had given rise to an industrial revolution. He couldn't have picked it up from England, says Coleman, because "despite much contemporary comment on economic change and its social consequences, the concept of an industrial revolution…seems at that time to have been virtually unknown in Britain, and the term itself hardly ever used, if at all." Note that Arnold Toynbee was born just as Engels was writing that book, and he had to reach maturity as a scholar before the concept took hold among British thinkers.

Toynbee provided more illumination (to me) on what happened to economic thinking over the first 75 years after Adam Smith than any textbook on the history of economic thought that I have read. (Not an exhaustive list, I should add.) It is at least as much about the thinking of economists and their influence on policy as it is about the kinds of events that one might expect from a chronology of "economic history." It is the explanation of an explosive era where what was happening was closely integrated with the thinking of economists. Two features stand out, for me. First is a sharp critique of the method of the classical economics; the second is the perverse effect of that method toward the end of the classical period when it became an ideological weapon against important reforms of the industrial system. Among the nuggets you will encounter is this summarization of the classical economists: Adam Smith showed how freedom from old institutional constraints *increases* the wealth of a nation; Malthus focused on the *causes of poverty* – and found it in the principle of population; Ricardo showed how wealth is *distributed* under a system of industrial freedom; Mill focused on how it *ought to be* distributed (pp. 58-9 in the Beacon paperback).

Ricardo and the Rent Concept

If you have a copy of the book readily to hand, I especially recommend three chapters in the middle: "The Mercantile System and Adam Smith," "The Chief Features of the Revolution" and "Ricardo and the Growth of Rent." If you do *not* have the book, then you can get a more complete copy to read on screen or in print. Click on http://books.google.com and look for *Lectures on the Industrial Revolution in England* by Arnold Toynbee, one that is identified on the first page as a copy belonging to the Oxford Divinity School, dated 1885 and with a biographical introduction by Benjamin Jowett, Master of Balliol College. There are 304 pages in all. Make sure to get this one, for there are other, shorter versions available via Internet. And do read the Introduction by Jowett, to get a picture of how this material came to be and of the high esteem in which the young author was held by his students and faculty associates. (He died while in the midst of a debating campaign with Henry George over the merits of the single tax on land.) And for even more illumination on the history of economic thought than is available in the 1956 Beacon Press edition, read the first two sections in the *Lectures* that are titled "Ricardo and the Old Political Economy." These were apparently intended to be part of a book that death of the author has stolen from us.

His critique is the focus of Ricardo on deductive method – deriving a doctrine from a few unexamined premises. As an historian, Toynbee was himself committed to empirical research – developing generalizations inductively from looking at factual evidence. He tells us that Ricardo was really unconscious of the method he was using. This confusion is the more remarkable because the classical doctrine was very much *political* economy, with a focus on institutional impediments to the freedom of enterprisers and laborers to be maximally productive. Adam Smith started the tradition; he opposed medieval restrictions on the ability to men to enter or change vocations or to move to other locations where better jobs were available. Businessmen were in favor, but once that freedom had been won, working men found that their survival depended on joining hands to fight back against the power of employers to exploit them. The response of capitalists and economists was to invoke Adam Smith and the evils of restrictive combinations (unions). You have doubtless noticed that free lunchers of today do the same. Toynbee suggested that if Smith had attempted to analyze competition "he would have become conscious of the fatal flaw in his doctrine. …[W]hat he sought to establish was the *free competition of equal industrial units*, [but] what he was in fact helping to establish was the *free competition of unequal industrial units*. This was a disastrous oversight."

The situation described by Toynbee was strikingly parallel to our own times. The classical doctrine had been very popular and contributed importantly to growth of the industrial system, but by about 1850 it had run out of gas. It was not coping with the pauperism and other disbenefits of industrialization, and policies based on it were aggravating the problems. Indignant and cogent critics were circling around the keepers of orthodoxy and several years remained before the neoclassical revolution restored a firm footing (Alfred Marshall's *Principles*). Most remarkable or ironical of all is Toynbee's characterization of Ricardo's method as relentlessly deductive, an approach he maintained stubbornly (uncomprehendingly) in spite of the best efforts of Robert Malthus to get him to pay attention to facts. He was the first of economists to exemplify the motto "If the facts don't agree with my theory, too bad for the facts!" Fast forward to 1950 and the Chicago School neoclassicist Milton Friedman who famously argued that "the realism of assumptions doesn't count!"

Keith Wilde

Resolutions for CAP Conference

Resolution 1

So-called subprime credit that has engulfed much of the international banking system threatens consequences more grim than those of the Great Depression of the 1930s and its sequel in WWII. So grim was the effect on the credit system of the Crash of October 1929 that by the time President F.D. Roosevelt was inaugurated for his first term at the beginning of 1933. 9,000 US banks had shut their doors, and one of Roosevelt's first acts was to declare a bank moratorium during which no banks were open. Roosevelt, conscientious and open-minded listened to all economists and finally arrived at a solution that restored the banking system and restricted it rigorously to banking. Banks were forbidden to acquire interests in the other "financial pillars": stock brokerages, insurance and mortgage companies.

There was a good enough reason for this. Each of these "other pillars" retained a cash reserve for the needs of their own business. Allow the banks access to these, and they will use them as the cash basis for applying the bank multiplier, the very essence of the art of banking – creating say as much as 10 times the cash in the bank's vaults by lending it out for interest. So long as the banks could honour all claims to the deposits they had taken in, they were in the clear, but when they expanded their cash base with the cash reserves of the other pillars the country was in trouble.

Note well. The 1933 bail-out of the banks is the only instance in the history of bank bail-outs in which the banks on being bailed out were seriously regulated rather than being deregulated further and allowed to acquire greater political power. Bail-outs have averaged about once every seven years since the banks were deregulated again by the 1970s.

Notable is the appointment of the new Governor of the Bank of Canada a former high executive of a bank, rather than someone from the Bank of Canada staff or an international institution like the IMF.

We draw the attention of the Conference that without the removal of the Rooseveltian restrictions on what non-banking interests banks could acquire there could have been no subprime mortgage crisis that threatens to flatten out the world banking system.

Resolution 2

As the banks were bailed out from their speculative forays into non-banking financial territory, subservient governments granted further non-banking powers to them. And the economic curricula of our universities were cleansed even of the memory of the great writings of economists such as John Maynard Keynes and John Kenneth Galbraith. Early retirement and zero hiring of those who did not respect this censorship, completed the sweep. Particularly since the bailout following the massive losses of banks in acquiring Savings and Loans, Enron where at least one Canadian bank was allowed billion dollar settlements out of court with class actions against Enron scams actually designed by a Canadian bank. Characteristically, this shameful use of the bank's capital was partly recouped by the bank in question as a tax credit in Canada.

It is necessary to make this invaluable suppressed economic literature available once again in economic courses, and in public and university libraries. The goal is not to adopt blindly any of the principles of the great economists stricken from the officially recognized literature but to invite critics of their writings to enter the discussion. This project might well be titled the McGeer Project, because the works of this self-taught economist antedated the writings of Keynes, went further than Keynes ever did in developing the functions and theory of nationalized central banks. It was largely his tireless and prophetic writings that led Prime Minister Mackenzie King to nationalize the bank of Canada in 1938.

COMER has the commitment of one million dollars from a private individual to establish a fund to set up a course at initially a single one of our universities. This will have to be closely reviewed and monitored to ensure that its purpose is followed. CAP and other organizations are invited to support this project, by seeking out likely universities and joining in the routine checks to make sure that the purpose of the project is fulfilled takes shape with safeguards that the desired goal will be respected.

Resolution 3

COMER, on the initiative of Connie Fogal, who is both leader of CAP and a member of COMER in good standing, has retained Rocco Galati, a lawyer experienced and devoted to such suits, to take to the Supreme Court the breach of the *Bank of Canada Act* which is still on the law books of the country. It would be helpful if CAP joined in publicizing the importance of the initiative.

Resolution 4

The notion of what is inflation – meaning an excess of demand over available supply – must be re-examined. It is correct that when there is a shortfall of supply to demand prices will rise. But that proposition, just as any other proposition, cannot be turned around. To assume it can, would get you flunked in an elementary course of logic.

Example: If a man holds a loaded revolver to his temple and pulls the trigger, he will fall dead. But that does not mean that the proposition turned around is necessarily correct. If a man falls dead it cannot be taken to prove that he shot himself. There are thousands of other possibilities that may have caused his death.

To mention just one of the alternative explanations for rising prices. When I move from a town of, say, 20,000, to New York City, I am not fool enough to expect my living costs to remain the same. How then can economists assume that, when humanity over recent decades has been making just such a move. Average life spans have moved upward, and this involves more public services whether provided by the state or the private sector.

COMER has done original work published in France 35 years ago, recognizing that an independent factor in the systematic rise of prices having nothing to do with the supply-demand relationship, results from the increase of infrastructural services paid for by the government. This – which COMER calls "the social lien" – represents the deepening layer of taxation essential for running a contemporary society.

Our statistics department on the trail of this element of price rise that was clearly not related to an excess of demand over supply, when the Mulroney budget slashed its budget with the warning that it drop the researches in question. PAC must demand that they be resumed.

Resolution 5

The Rooseveltian banking reform, which became the model throughout much of the Western world, provided an alternative to raising the benchmark central bank interest rate in the statutory reserves that banks had to redeposit with the central bank from the deposits made with them by the public.

However, particularly since the 1970s, the banks having cleaned up their balance sheets during the years when they were restricted to banking, were lobbying for further deregulation and globalization. By the 1980s in particular, they lost much of their capital in their involvement with mortgages, and to bail them out from their plight, the Bank for International Settlements – which conducted the comeback plans of the world's banks – brought in its *Risk-Based Capital Requirements* for banks of developed countries. This declared government debt of such governments to be "risk-free" hence requiring no down payment for the banks to acquire. As a result the Canadian banks increased their holdings from around $20 billion to $100 billion.

The elimination of the statutory reserves between 1991-3 left the benchmark interest rate the only device for the central bank to dampen or stimulate the economy. And that awarded unique control position of the economy to the speculative financial sector, whose primary revenue is interest.

Money in Trouble

It is difficult to believe that the smartest people on the "Street" and neither Robert Rubin who departed from government as Treasury Secretary in 1999 to become a treasured top executive at Citigroup, nor the "Sainted" Alan Greenspan who led the US through those many years of supposed prosperity as Fed Chairman, do not understand money creation.

Joe Sixpack can be forgiven his ignorance of creating money because he doesn't. He believes money comes from his employer as a paycheck or from a bank which loans him money taken out of its vault. Joe knows that when he loans his brother-in-law $100 it comes out of his own pocket. Commercial banks regulated by the Fed, create the money they loan Joe Sixpack out of thin air. That loan is brand new money, printed if you will, by the bank under strict oversight, we hope, of the Fed.

The bank demands interest be paid on this new money, debt-money it is called, to distinguish it from legal tender, cash, printed by the US Treasury which earns no interest. More confusing to Joe, the bank calls his loan an asset while Joe calls his loan a liability. Words, words, words!

So what is the "backing" of this new interest earning bank created money? It is the faith the bank has in Joe that he will pay interest on it and repay the loan on schedule. A Federal Reserve Note, "This note is legal tender for all debts public and private," printed and spent by the US government, is backed only by the "Faith and Credit" of the US government. As has always been the situation, money is anything accepted as such and is only worth what it can buy. Why then is bank created money, credit, vital to the functioning of the Economy while Treasury printed money is decried as inflationary?

US Treasury Secretary Rubin got the *Glass-Steagall Bank Act* of 1933 repealed in 1999, his last "success" before leaving for Citigroup, or as his Wall Street friends joked, his first act as Citigroup executive. Until then commercial banks with a limited right to print money could not legally own corporations which borrowed it but were doing so clandestinely anyway. Wall Street considered this an old fashioned view of finance, a legacy of the crash of 1929, needlessly limiting the activity of today's well managed banks. Now we see Bear-Stearns an "investment" bank which can't print money bought by J.P Morgan Chase which can print money. To broker the deal, the Fed granted J.P. Morgan Chase a 28-day "loan" of $29 billion of legal tender, cash, fresh from the US Treasury!

Well managed banks were happy to create money for secretive hedge funds, high risk mortgages, corporate take-over schemes, and to finance credit cards which allow consumers to effectively print their own money. To disperse the risk of all this kind of money-creation, loans were repackaged and resold to buyers far removed from the original loans. In old fashioned banking the bank and the loanee stayed together and shared the risk jointly. Banks monitored these loan assets on their books of accounts and were quick to handle any challenges which might arise.

This latest and perhaps terminal world financial crisis arises from defaulting original loanees who are untraceable. There are no "holders in due course" accountable for defaulting loans. No private party wants to gamble on buying tranches of sliced and diced debt. What are they really worth? Let the market decide? The original selling price? It's anybody's guess!

The Bank of Last Resort is again the Fed in the US and the central banks of other countries which print legal tender. How much like the Great Depression era game of Monopoly where the banker would hand out new money to keep the game going! Desperate to keep the world economy going, central banks are now effectively buying these tranches with legal tender only they can print to restore deficient bank reserves.

What seems lost in the noise is the fact that all this "funny money" has built great amounts of new private homes. The owners may default but a real material asset remains no matter the bookkeeping. The US Treasury, to finance production of war materiel to win WW II, printed money to pay the women factory workers while men were mostly unemployed in productive labor fighting on front lines destroying real property. To sop up the great amounts of new money entering circulation with no civilian products to buy, War Bonds at $18.75 were sold. In 4 years WWII was over and to protect a reviving peacetime market economy vast amounts of left-over war materiel with peaceful utility was destroyed!

There is strong evidence that the remarkable Chinese economy with a steady incredible growth in housing, highways, and consumer products selling to an affluent middle class, is a result of the Chinese government printing money for peaceful purposes as did the US in WWII for warfare. The Chinese government does not seem to carry a national debt and sells Chinese Treasury bonds to cool it's economy not to finance it! With so much mind boggling infrastructure construction pouring yuan into circulation, some cooling seems necessary.

This May China increased the commercial bank reserve requirement again to now 16% reducing the quantity of loans they can make to a maximum of 6X their reserves. This is an alternate way to reduce bank money creation rarely used in the USA in preference to the "one blunt tool" of increasing interest rates which bankers like!

Could this be the money model, a Chinese model, for a world economy to replace the dysfunctional financial system now in crisis?

R.W. Zimmerer

The BIS, and all the central bankers, around it overlooked a detail. To fight inflation that could be expected from such a great infusion of capital into the banking systems, the BIS raised interest rates to the heavens, proclaiming "zero inflation" – i.e., an absolutely flat price level as alone acceptable. But with the banks loaded up with completely leveraged government bonds issued earlier with drastically lower coupons, the banks suffered a massive loss on such bond hoards. This caused a major monetary crisis in Mexico that threatened to bring down the world financial system. Mexico's banks closed their doors and, though only recently privatized again, once again were taken over by the government. Eventually 85% of the banks of that proudly nationalist country ended up under foreign control.

The Mexican banking crisis was prevented from bringing down the world banking system, an emergency fund of $51 billion was put up by the USA, the IMF, and Canada. It was not used, but the United States government had learned an important lesson. It became clear that the age of sky-high interest rates was over. For the deregulated banks were in no position to forgo the mountains of government debt they were now authorized to acquire with no down-payment.

A way out was devised by Clinton's Secretary of the Treasury, Robert Rubin, a Wall Street alumnus. With very few exceptions, governments of the day did not keep their books according to the double-entry system supposed to have been brought back from the Near East by the Crusaders about a thousand years ago. That requires that each transaction enter the firm's ledger twice: once as the value of a given acquired asset depreciated over its likely period of usefulness, and then the amount of money paid for it amortized over a reasonable period. That is known as accrual accountancy or capital accountancy; the system by far most governments employed as "cash accountancy." By this the debt incurred for the acquisition was carefully amortized over the term of its financing, but the value of the asset was written off in the year when the transaction was concluded. Obviously that left a deficit that was not really there. Private firms employing such bogus accountancy would find themselves in deep trouble when the tax sleuths caught up with them. But the fictitious bookkeeping of the governments themselves had considerable strategic advantages. It bolstered the argument, that we cannot afford social programs, and above all it made for some handsome privatization deals when highly expensive real estate or other infrastructure booked at a minute portion of its real value.

The Clinton government got around that difficulty when it switched to accrual accountancy and replacing $1 dollar token value with a properly amortized value of the asset, and working the conversion back to 1959, came up with some $1.3 trillion dollars of greater asset value. That first appeared in the Secretary of Commerce's statistics in January 1996, but under the headings of "Savings," which economists apply only to cash or assets readily convertible into cash. However, a nudge and a wink to the appraisers, whom we know from the current subprime investigations to be highly obliging folk, did the job. The lower interest rates that ensued from the revelation of so much net value in the government's estate brought in low interest rates that gave Clinton a second term, rewarded the nation with the prolonged technological boom that burst only as the new millennium had its foot in the door.

How dear the bogus low pricing has been to the private financiers appears from the persistent refusal to bring in accrual accountancy in Canada, even though the Auditor General refused to sign off on two annual reports on government financing. Finally a sordid compromise was reached when the government switched to accrual accountancy – but only when it had elicited a degrading statement from the AG to the effect that since no new money had entered the Treasury as a result of the agreement, it should not be taken as a reason for expenditures on new programs.

However, when the successive bailouts of our banks had left holes in the federal treasury the federal government had downloaded crucial social programs onto the provincial governments without the revenue to pay for them, a compliment that the provinces lost no time in passing on to the municipalities.

That is the origin of the potholes in our roads, and the violence in our schools.

We must ask that serious double-entry accountancy be brought into the finances of the nation. The Bank of Canada must be used for the purposes for which it was nationalized in 1938, at a good profit for the 12,000 private shareholders who had held their shares only for four years. Both the federal and provincial governments are eligible for financing both their funded and unfunded debt in generous amounts. Municipalities, as corporations, can with guarantee either of the federal or of a provincial government.

The interest paid on such loans, of course, would come back as dividends only to the federal government which is the Bank of Canada's single shareholder. But the federal government could reach a fair arrangement with the province or municipality that may have used Bank of Canada financing. It would straighten out the tangled financial relations of the different government and help usher in a happier period in the relations for our various levels of government.

Resolution 6

After World War II, Washington sent hundreds of young economists to Japan and Germany to assess how long it would take for the two major Axis powers to rebuild their economies enough to become once again formidable competitors on world markets. Twenty years later, one of these, Theodore Schultz of the University of Chicago, wrote that it is astounding how wide of the mark these economists had been in their predictions. This he attributed to the fact that they had concentrated on the physical destruction in the conflict, and had overlooked the fact that the work force and technical personnel had come through virtually intact. And from this he concluded that the most productive investment a nation can make is in its human capital – in the skills, and hence the health and social welfare of its work force. For this Schultz was awarded the so-called Nobel Peace Prize – awarded by the Bank of Sweden, and enjoyed a brief celebrity. Today COMER seems just about the only organization to remember either his name or the idea that holds to keys to running our society. We underline that not only must society's investment in human capital be properly depreciated, but the period of such depreciation stretches over generations, since the children of well-educated well cared-for parents tend to be more readily educated and healthier in every sense of that word.

COMER therefore moves that human capital be recognized as an investment and handled in the nation's accountancy as such, This will stop the use of key social investments as political scarecrows to deceive the electorate.

Resolution 7

It is impossible to find your way through the overgrown subprime debt jungle that the world has become, unless you realize that there are two types of debt. The debt of our federal government that is spent into existence and hence bears no interest, and there is the debt lent into existence by banks which does bear interest.

The government's borrowings from the Bank of Canada, of which it has been the sole shareholder since 1938, is the only legal tender in our land – that must be accepted in payment of any debt. The interest charged the government by the Bank of Canada comes back to the federal government almost entirely in the form of dividends. The credit of the government when extended to domestic purchases or investments. is backed by its taxing powers over the nation, the skills, talents and education of its inhabitants, and the wealth of our environment. That is why all these capital assets – whether they are traded on the market or not – must be preserved and properly valued when privatized.

That is basic to understanding our economy. The word "debt" calls to mind a negative sign before a number of dollars, but government debt would be more realistically conceived would be better understood if we trained ourselves to think of it with a large positive sign before it.

Of course, the government must handle its own spending – and hence the country's money creation responsibly. That is why PAC has emphasized the need for double-entry bookkeeping, that would keep track not only of the amortized debts of government investment but also of the depreciated value of its investments – both in physical investments and in human capital. (See Resolution 6.) ■

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 *The 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.'"

A Foretaste of the Mortgage Storm

"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 January 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 it 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.

"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."

Record-setting Mortgage Defaults

"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 servicer in the nation, administering $1.5 trillion in loans by other institutions as well as its own. 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, defaults 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 a $100 million loss in the same period of 2007. Even as Countrywide's loan servicing portfolio rose 10 percent in the first quarter, operating earnings in the business fell to $463 million from $640 million in the same period of 2007.

"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 Final Wild Card

"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; if 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 taking interests in the other "financial pillars" – stock brokerages, insurance and mortgages. For that puts within their 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.

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Parable *from page 1*

while iron-ore prices have risen about 70%.

"'The structure of the steel industry is changing,' says Peter Fish, Chairman of MEPS International Ltd., a London-based steel research and consulting firm. 'It used to be that the raw materials accounted for 15% of selling prices. Now they account for about 50% of selling prices.'

"Some analysts say steelmakers are buying at the top of the commodity cycle and are overpaying as a result."

Of course, that shows a conviction that the world still runs in cycles and at best is subject to an occasional flat tire. Once the mad push for ever accelerating industrialization takes over, it leads to the military option when there is no other way out and that, too, if memory does not deceive us, produces a still greater hunger for steel.

"While China is a huge consumer of steel, it is largely bereft of quality iron-ore deposits, which is why several Chinese steelmakers are moving to secure their own supplies.

"CSN, one of Brazil's leading producers of both steel and iron ore, has invited bids for all or part of Nacional Minerios SA, or Namisa, its unlisted iron-ore unit. Major Chinese producers including Baosteel Group Co., Shougong Group and Shagang Group, as well as China Investment Corp., a $200 billion investment pool run by the Chinese government, are interested in the unit, one person familiar with the situation said.

"CSN has hired Goldman Sachs Group Inc. as its financial adviser for the sale.

"Last Friday, Sinosteel Corp., a state-owned Chinese steelmaker said it boosted its stake in Australian iron-ore group Midwest Corp. slightly to nearly 44%, further boosting its efforts to take over that company.

"Other, smaller Chinese steelmakers are also trying to line up more iron ore. Tonghua Steel, the largest steelmaker in northeast China's Jilin province, plans to buy or invest in eight mines near its mills. Company officials say Tonghua can supply only about 20% to 30% of its own iron ore needs. The company hopes to increase its self-sufficiency in ore to more than 50% by the end of 2010.

"Taiyuan Iron & Steel, a carbon-and stainless-steel producer based in northern China's Shanxi province has said it plans to raise its self-sufficiency to 80% from 50%.

"As Chinese steelmakers go on the prowl for resources, Marius Kloppers, chief executive of Australia-based mining giant BHP Billton Ltd., one of the world's biggest iron-ore producers, said he wouldn't be surprised by a Chinese buy-up of his company's shares.

"The race for raw materials is also heating up in other parts of the world. Brazilian steelmaker Usinas Siderurgicas de Minas Gerais SA or Usiminas, says it will spend $750 million to invest in more mines over the next five years to nearly quintuple its iron-ore production to 29 million metric tons a year. Usiminas already has spent $1 billion this year to buy miner J. Mendes and its subsidiaries. In India Steel Authority of India Ltd. and Tata Steel signed a deal earlier this year to form a joint-venture coal-mining company.

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