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A Shift in the Attack Calls for Revised Defense Paradigm

The New York Times (27/08, "Willing to Lease Your Bridge" by Jenny Anderson) reports a shift in the line of attack of the battered high financial sector: "Reeling from more exotic investments that imploded during the credit crisis, Kohlberg Kravis Roberts, the Carlyle Group, Goldman Sachs, Morgan Stanley and Credit Suisse are among the investors who have amassed an estimated $250 billion war chest – much of it raised in the last two years – to finance a tidal wave of infrastructure projects in the United States and overseas.

"Their strategy is gaining steam in the United States as federal, state and local governments previously wary of private funds' struggle under mounting deficits that have curbed their ability to improve crumbling roads, bridges and even airports with taxpayer money.

"With politicians like Gov. Arnold Schwarzenegger of California warning of a national infrastructure crisis, public resistance to private financing may start to ease.

"'Budget gaps are starting to increase the viability of public-private partnerships,' said Norman Y. Mineta, a former secretary of transportation recently hired by Credit Suisse as a senior adviser in such deals.

"This fall, Midway Airport of Chicago could become the first to pass into the hands of private investors. Just outside the nation's capital, a $1.9 billion public-private partnership will finance new high-occupancy toll lanes around Washington. This week, Florida gave the green light to six groups that included JPMorgan, Lehman Brothers and the Carlyle Group to bid for a 50- to 75-year lease on Alligator Alley, a toll road known for sightings of sleeping alligators that stretches 78 miles down 1-75 in South Florida.

"Until recently, the use of private funds to build and manage large-scale American infrastructure assets was slow to take root. States and towns could raise taxes and user fees or turn to the municipal market.

"Americans have also been wary of foreign investors taking over their prized roads and bridges. When Macquarie of Australia and Cintra of Spain, two foreign funds with large portfolios of international investments, snapped up leases to the Chicago Skyway and the Indiana Toll Road. 'People said, "hold it, we don't want our infrastructure owned by foreigners,"' Mr. Mineta said.

"The specter of investors reaping huge fees by financing assets like the Pennsylvania Turnpike also touches a raw nerve among taxpayers. They already feel they are paying top dollar for the government to maintain roads and bridges.

"And with good reason: private investors recoup their money by maximizing revenue – either making the infrastructure better to allow for more cars, for example, or by raising tolls. (Concession agreements dictate everything from toll increases to the amount of time dead animals can remain on the road before being cleared.)

"Labor unions have been quick to point out that investors stand to reap handsome fees from the crisis in infrastructure.

"But in a world in which governments view infrastructure as a way to manage sustainable growth and raise productivity through the efficient movement of goods and people, an eroding economy has forced politicians to take another look.

"Traditionally, the federal government played a significant role in the development

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Paradigm *from page 1*

of the nation's transportation backbone: Thomas Jefferson built canals and roads in the 1800s, Theodore Roosevelt expanded power generation in the early 1900s and during the New Deal (sic!). In the 1950s Dwight Eisenhower oversaw the building of the interstate highway system.

"But since the early 1990s, the United States has had no comprehensive transportation development, and responsibilities were increasingly pushed off to states, municipalities and millions of metropolitan planning organizations. 'Look at the physical neglect – crumbling bridges, environmental concerns,' said Robert Fuentes, a transportation and metropolitan growth expert of the Brookings Institution.

"The American Society of Civil Engineers estimates that the United States needs to invest at least $1.6 trillion over the next five years to maintain and expand its infrastructure. Last year, the Federal Highway Administration deemed 72,000 bridges, or more than 12% of the country's total, 'structurally deficient.' But by the end of this year, the highway Trust Fund will have a several billion dollar deficit."

An Infrastructure Crisis Threatens

"'We are facing an infrastructure crisis in this country that threatens our status as an economic superpower and the health and safety of the people we serve,' New York Mayor Michael R. Bloomberg told Congress this year.

"Some American pension funds see an investment opportunity. 'Our infrastructure is crumbling, from bridges in Minnesota to our airports and freeways,' said Christopher Ailman, the head of the California State Teacher's Retirement System. His board recently authorized up to about $800 million to invest in infrastructure. The Washington State Investment Board has allocated 5% of its fund for such investments.

"Some foreign pension funds that jumped into the game early have already reaped rewards. The $52 billion Ontario Municipal Employee Retirement System saw a 12.4 percent return last year on a $5 billion infrastructure investment pool, above the benchmark 9.9 percent, though down from 14% in 2006.

"The prospect of steady returns has drawn high-flying investors like Kohlberg, Kravis and Morgan Stanley to the table. 'Ten to 20 years from now infrastructure could be larger than real estate,' said Mark Weisdorf, head of infrastructure investments at JPMorgan. In 2006 and 2007, more than $500 billion worth of commercial real estate deals were done."

That is hardly reassuring. We would risk ending up with subprime bridges, roads and harbours if we stayed on that route.

But suppose we concentrated on re-examining our accountancy paradigms. Then we would find that our budgetary deficits were bogus since they ignored the vast but still inadequate investments that the government has been making. These have been treated as current expenditure when in fact they had been identified by Theodore Schultz, on the basis of the rapid recovery of Germany and Japan after World War II, as the most productive investments a government could make. Likewise the investment of government in physical infrastructure was under immense pressure but was finally recognized in the US but booked as "Savings" which they were not, since they are not in cash or near-cash as "savings" implied. And on top of that in Canada the central bank is government-owned, which means that if infrastructure is financed by the federal government through the Bank of Canada, the interest paid on such financing comes back substantially to the federal government as dividends. There is, moreover, the detail that the *Bank of Canada Act* is still part of the law of the land, though completely disregarded.

So there is no legitimate reason for our government depending on banking corporations to finance whatever infrastructures we need when it can be done practically interest-free through our nationally owned central bank, after we have brought in double-entry bookkeeping. High time we did since it was first brought to Western Europe from Arab lands by the Crusaders more or less a thousand years ago. Time enough for our government to have caught up with it.

Globalization and Deregulation, moreover, has made much existing infrastructure antiquated and even irrelevant.

And some surprising aspects to this woefully neglected resource. By catching up with our educational and health needs, and properly listing the money spent for human education and training and hence for health and other key social services, the government's balance sheet suddenly would appear well-balanced. And not hopelessly locked in subprime collateral but invested in increased productivity due to adequate investment in human capital. It can do its financing through its own central bank at a negligible cost. Its financial position is so uniquely strong that it can look after maintaining its infrastructures itself without bringing in foreign – or domestic financial institutions that have gambled themselves into subprime category. For them taking over the infrastructure needs of governments can be the last hope of becoming solvent once more.

That governments should turn to financial firms whose speculations have brought the world into the subprime era, smacks heavily of corruption.

And there is a more obvious basis for this seemingly surprising solution. Investing in human capital will leave the country well provided with domestic engineers and other specialists to do the job.

There can be sound but seemingly black magic in human affairs: providing enough education, health, and social services and properly entering such investment in the government's books as investment. That would make it possible for the government to finance all its necessary infrastructures through it own central bank in the most provident of ways. Let's do it. At once.

William Krehm

Does the Bank Bailout Policy of our Government Reduce to a Swap?

The plight of the gambling banks of the US and Canada is hardly improving. Hearken to *The New York Times* (22/08, "Burdened by Mortgages, Lehmann's Options Narrow" by Jenny Anderson): "As the stock of Fannie Mae and Freddie Mac have plummeted, financial shares have taken a beating. But few have suffered as much as Lehman Brothers, the troubled investment bank whose stock plunged more than 10% on 11 days of the last quarter.

"In the last 12 months, Freddie's stock price has dropped 95%. During that same period, Lehman has fallen 76%. The Standard & Poor's financial index has lost 42%. By way of comparison Merrill Lynch is down 68%. and Citigroup is down 64%."

Feeding on one another will obviously get the great financial engineers nowhere. So what they need is a swap with the national treasuries that will turn a loss into a gain by the black art of insurance used to insure banks against real or imaginary losses.

"The connection between Lehmann, Fannie and Freddie is clear, said Richard X. Bove, an analyst at Ladenberg Thalmann. 'Lehmann's business is broader than Fannie and Freddie, but the link is that they were doing the same thing – packaging mortgages and selling them,' he says.

"Furthermore, the investment bank and the government-sponsored entities held the mortgages, which are now creating the losses and forcing the companies to raise capital in a market not so willing to provide it.

"Real estate woes have been widespread on Wall Street. Merrill Lynch has taken $45 billion of write-downs and Citigroup has written down about $40 billion in assets. They, too, barrelled into the mortgage business and their shareholders and employees are now paying the price.

"But Lehman has remained in the center of this storm because of its smaller size, its significant mortgage exposure – about $61 billion in mortgages and asset-backed securities – and its seeming reluctance to take drastic steps. Citigroup sold off its large German consumer banking franchise, while Merrill Lynch recently bit the bullet and sold a $31 billion portfolio of mortgage-related collateralized debt obligations for 22 cents on the dollar, as well as its stake in Bloomberg L.P.

"Lehmann declined to comment on its plans. After a dismal quarter, analysts have now slashed their third-quarter estimates for Lehman. Where they had expected a small profit, they now predict a write-down of up to $4 billion and a loss for the quarter of $3.30 a share.

"Lehmann has been exploring ways out of the mess. After losing $2.8 billion in the second quarter mainly because of write-downs in residential real estate investments, it raised $6 billion.

"Having tapped the markets and diluted shareholders, it is running out of options. It is shopping its commercial mortgage-backed business and roughly $40 billion in commercial real estate, according to people involved in the negotiations. It is also seeking bids in its investment management division, including the richly valued Neuberger Berman fund complex, according to people involved in the discussions. It has been seeking to sell a stake in itself to Korean wealth funds, according to a person briefed on the discussions.

"The investment bank is aggressively trying to reduce risk on its balance sheet by selling some assets (in the second quarter Lehman sold $22 billion in illiquid assets out of a total of $147 billion in assets).

"Investors have become increasingly skittish in the absence of a stated plan from management and as other economic conditions weaken. Global growth is slowing, and the outlook for Fanny and Freddie continues murky. Add in the continued deterioration in the commercial and residential mortgage market, and Lehmann has…found little room to maneuver."

41% Delinquencies

"According to data Standard & Poor's released on Thursday, more than 41% of the subprime mortgages made in 2006 are now delinquent. About 40% of the securities packaged and sold by Lehman with subprime mortgages from 2006 are delinquent – a smaller portion than at Merrill & Lynch and Morgan Stanley, but greater than those from Credit Suisse and JPMorgan.

"Mortgages to people with credit one rung higher than subprime, called Alt-A, are also being hammered. Standards & Poor's estimates that more than 21% of such mortgages made in 2006 are delinquent.

"Exacerbating the grim mortgage outlook is the generally bleak capital markets performance in the third quarter – an issue for all the firms, but again, one that seems to hit Lehman harder.

"Exacerbating the grim mortgage outlook is the generally bleak capital market performance in the third quarter.

"According to Goldman Sachs research debt underwriting – a major business for Lehman – has fallen off a cliff. For the industry, the underwriting of asset-backed debt is down 47% from the previous quarter, and mortgage-backed issuance is down 28%. Overall, asset-backed issues have fallen 80% from the 3rd quarter as year ago, and mortgage-backed offerings are down 87%."

Such details must be as well known to the Russians as those of the late Soviet Union were to Washington in its years of bleeding in Afghanistan. Much of the outcome in confrontation that is shaping will be determined by who boned up better for the supreme history examination where the questions and answers are penned in blood.

W.K.

Is a Drooping Birth Rate Helping the Environment?

The New York Times Magazine (29/06, "Childless Europe" by Russell Short) deals with the drop of the world birth-rate, tracking it to causes that have eluded economists.

"It was a spectacular late May afternoon in Southern Italy, but the streets of Laviano – a hamlet gloriously ranged across a few mountain folds – were deserted. There were no day-trippers from Naples, no tourists to take in the views up the steep slopes, the olive trees on terraces, the ruins of an 11th-century fortress with wild poppies sporting its grassy flanks like flecks of blood. The town has housing enough to support a population of 3,000, but fewer than 1,600 live there, and every year the number drops. Rocco Falivena, Laviano's 56-year-old mayor, strolled down the middle of the street, outlining for me the town's demographics and explaining why, although the place is more than a thousand years old, its buildings all look so new. In 1980 an earthquake struck, taking out nearly every structure and killing 300 people, including Falivena's own parents. Then from tragedy arose the scent of a possibility, of a future. Money came from the national government in Rome, and from former residents who had emigrated to the US and elsewhere. The locals found jobs rebuilding their town. But when that ended, so did the work, and the exodus of residents continued as before.

"When Falivena took office in 2002 for his second term as mayor, two numbers caught his attention; *Four:* that was how many babies were born in the town the year before. And *five:* the number of children enrolled in first grade at the school, not to mention that the school served two other communities as well. 'I knew my job was to save the school,' Falivena told me. 'Because a village without a school is a dead village.' He racked his brain and came up with a desperate idea: pay women to have babies. And not just a token amount. In 2003 Falivena let it be known that he would pay 10,000 euros (about $15,000) for every woman – local or immigrant, married or single – who wished to give birth and rear a child in the village. The 'baby bonus,' as he calls it, is structured to root new citizens in the town: a mother gets 1,500 euros when her baby is born, then a 1,500-euro payment on each of the child's first four birthdays and a final 2,500 euros the day the child enrolls in first grade.

"There are some indications that Falivena's baby bonus is succeeding – but the first-grade class Laviano is still losing population.

"Demographically speaking, Laviano is not unique in Italy, or in Europe. In the 1990s, European demographers began noticing a downward trend in population across the continent and behind it a falling birthrate. A 2002 study by Italian, German, and Spanish social scientists focused on the data and gave policy-makers across the European Union something to ponder. The figure 2.1 is widely considered the 'replacement rate' – the average number of births per woman that will maintain a country's population level. At various times in modern history – during war or famine – birthrates have fallen below the replacement rate, to 'low' or 'very low' levels. But Hans-Peter Kohler, Jose Antonio Ortega and Francesco Billari – the authors of the 2002 report – saw something new in the data. For the first time on record, birthrates in southern and eastern Europe had dropped below 1.3. At that rate, a country's population would be cut in half in 45 years, creating a falling-off-a-cliff effect from which it would be nearly impossible to recover. Kohler and his colleagues invented an ominous new term for the phenomenon: 'lowest, low fertility.'"

Record Drops Well Below Replacement of Population

"To the uninitiated that seems a strange thing to worry about. A few decades ago we were getting 'the population explosion' drilled into our heads. The invader species *homo sapiens*, we learned, was eating through the planet's resources and irretrievably wrecking its fragile systems. Has the situation changed for the better since Paul Ehrlich set off the alarm in 1968 with his best seller *The Population Bomb?* Do current headlines – global food shortages, climate changes – not indicate continuing signs of calamity?

"For one thing, around the world, even in developing countries, birth rates have plummeted – from 6.0 globally in 1972 to 2.9 today – as populations have shifted from rural areas to cities and people have adopted urban life styles. Meanwhile, in recent years another chorus of voices has sounded. Yes, we're straining resources, and it's undeniable that some parts of the globe are overrun with humanity. But in Europe, 'lowest low' isn't just a phenomenon of rural areas. Cities like Milan and Bologna have recorded some of the lowest birthrates anywhere, because of the high cost of living forces couples to move or have fewer children. After the term was invented, 'lowest, low fertility' got the attention of leaders in Brussels and national capitals across the continent – and now everybody from Seville to Helsinki seems aware of it. Around the time that President Kennedy went to Germany and gave his 'Ich bin ein Berliner' speech, Europe represented 12.5% of the world's population. Today it is 7.2%. And still going down.

"Nobody foresaw that the fertility rate would go so. In the 1960s the fertility rate in Italy was around two children per couple. Now it is about 1.3%. In Athens it's common to blame the city's infamous air pollution. More broadly, it's common to blame the low birthrate to secularism. 'Europe is infected by a lack of desire for the future,' Pope Benedict proclaimed in 2006. 'Children, our future, are perceived as a threat to the present.'"

In Germany, an Annual Population Loss of 100,000

"In Germany, where the births-to-deaths now results in an annual population loss of roughly 100,000, Ursula von der Leyen, Chancellor Angela Merkel's family minister (and a mother of seven), declared two years ago that if her country didn't reverse its plummeting birthrate, 'We will have to turn out the light.'

"Demographers and economists foresee that 30 million Europeans of working age will 'disappear' by 2050. At the same time, retirement will be lasting decades as the number of people in their 80s and 90s increases dramatically. The crisis, they argue, will come from a 'triple whammy' of increasing demand on the welfare and health systems, with ever smaller tax contributions from an ever-smaller work force.

"What's more, there will be a smaller working-population compared with other parts of the world. The US Census Bureau's International Database projects that in 2025, 42% of the people living in India will be 24 or younger, while in Spain 22% of Spain's population will be in that age group. And the troubles for Europe are magnified by other factors in the existing welfare states of many of its countries. According to the Adeco survey, only 60% of men in France between ages of 50 and 64 are still working.

"Then there is the matter of what kind of society 'lowest low' will bring. How will the predominance of one and two-child families affect family cohesion, sibling relationship, care for elderly parents? Imagine a family where family reunions consist of three people, in which nearly all of a child's relatives are in their 50s 60s 70s, 80s and nineties.' As social scientists Billari, Kohler and Ortega put it, Europe is entering 'an uncharted territory in demographic history.'

"Will Europe as we know it just peter out? Will ethnic Greeks and Spaniards become extinct, taking their Baklava and Paella to the grave with them, to be replaced by Muslim immigrants who couldn't care less about the Acropolis as a majestic representation of Western culture? Venice has lost more than half its population since 1950; its residents believe their city is destined to become a Venice-themed attraction. Is the same going to happen with Europe as a whole?

"To understand the global meaning of the low-birthrate phenomenon requires first examining Europe's 'baby bust.' Maybe the most striking way to set up the issue is via a statistic from a 2006 Eurobarometer Survey by the European Commission. Women were asked how many children they would like to have; the average result was 2.36 – well above the replacement level and far above the rate anywhere in Europe. If women are having fewer children than they want, there must be other forces at work.

"As it turns out, the situation differs by region. 'There are really four different population changes happening in Europe, said Alsair Murray, director of Centre Forum, a London-based research group. One concerns Eastern Europe, where trends date from the Communist period and portend an especially virulent class of problems. Bulgaria's birthrate is 1.37. and life expectancy by males is seven years less than in Belgium and Germany. EU estimates that Bulgaria's population will drop from 8 million today to 5 million in 2050. Throughout most of Eastern Europe you see the same dark elixir of forces at play, which commentators attribute to Westernization, though it's difficult to fix causes precisely. We can see that birthrate declines date to the fall of the Soviet Union,' Murray said, 'but is that due to the switch to a market economy or something else?'

"Germany and Austria are in a category of their own. They share many of the same characteristics of other Western European countries with regard to forces affecting family life, but in addition childlessness is peculiarly high in these countries, and has been for some time. A 2002 study found that 27.8% of German women born in 1960 were childless, a rate far higher than in any other European country. (The rate in France, for example, was 10.7.) When European women age 18 to 34 were asked in another study to state their ideal number of children, 16.6 in Germany and 12.6 in Austria answered 'none.' (In Italy, however, this figure was 3.6%.) The main reason seems to be a basic change on the part of some women as to their 'natural' role. No one has yet figured out why some countries are more disposed to childlessness than others."

The Puzzle of Family-friendly Italy, Spain and Greece with the Lowest Births

"But the true fertility fault line in Europe runs between north and south. Setting aside the special case of countries in the east, the lowest rates in Europe and the world are to be found in the seemingly family-friendly countries of Italy, Spain and Greece (all currently about 1.3). I asked Francesco Billari of Bocconi University in Milan, an author of a 2001 study that introduced the 'lowest, low concept, to account for this. 'If we look at very recent data for developed countries, we see that Italy has two records that may be world records,' he said. 'One, young people in Italy stay with their parents longer than maybe anywhere else. No. 2 is the percentage of children born after the parents turn 40. These factors are related, because if you have a late start, you tend not to have a second child, and especially not a third.'

"And then we come to some basic economic details that have a direct bearing on the oddities under discussion.

"On the surface there are economic explanations why this phenomenon has occurred in southern Europe. Italy, for example, pays the lowest starting wages of any country in the EU, which causes young people starting out on their own to begin by living with their parents. And as the British politician David Willetts has noted, 'Living at home with your parents is a very powerful contraception.'

"But the deeper problem may lie precisely in the family-friendly ethos of these countries. In all these countries, Billari said, it's very difficult to combine work and family. And that is partly because, within couples, we have evidence that in these countries the gender relationships are very asymmetric."

Asymmetric Gender Relationships

"There, according to waves of recent evidence, is the rub – the result of a friction between tectonic plates that has been quietly accepted for decades. The accepted demographic wisdom has been that as women enter the job market, a society's fertility rate drops. That has been broadly true in the developed world, but more recently, especially in Europe, the numbers don't bear it out. According to Hans-Peter Kohler of the University of Pennsylvania, recent analysis showed that 'high fertility was associated with high labour-force participation…and the lowest fertility level was associated in Europe since the mid-1990s is often found in countries with the lowest female labour-force participation.' In other words, working mothers are having more babies than stay-at-home moms.

"How can that be? A study released in February of this year by Letizia Mencarini, the demographer from the University of Turin, and three of her colleagues compared the situation of women in Italy and the Netherlands. They found that a greater percentage of Dutch women than Italian women are in the work force but that at the same time, the fertility rate in the Netherlands is significantly higher (1.73 compared to 1.33). In both countries, people tend to have traditional views about gender roles, but Italian society is considerably more conservative in this regard, and this seems to be a decisive difference. The hypothesis the sociologists set out to test was borne out by the data: women who do more than 75% of the housework and child care are less likely to want to have another child than women whose husbands or partners share the load. Put differently, Dutch fathers change more diapers, pick up more kids after soccer practice and clean up the living room more often than Italian fathers; therefore, relative to the population, there are more Dutch babies than Italian babies born.

"Accompanying the spectacular transformation of modern society since the 1960s – notably the changing role of women. with greater opportunities for education and employment, the advent of modern birth control and a new ability to tailor a life-style – has been a tension between forces that, in many places, have not been reconciled. The tension is perfectly apparent, of course. Ask any working mother. But some societies have done a better job than others of reconciling the conflicting forces. In Europe, many countries with greater gender equality have a greater social equipment for day-care and other institutional support for working women. That gives those women the possibility of having second or third children.

"There is a crucial difference between the north – including France and Scandinavian countries – and the south. The Scandinavian countries have both the most vigorous social-welfare systems in Europe and – at 1.8 – among the highest fertility rates. To better understand this north-south divide, I met with two sociologists who personify it: Letizia Mencarini and Arnstein Aassve, a Norwegian who last year took a position at Bocconi University that is becoming a centre of demographic research in Europe. Over lunch of linguine with walnuts and arugula at an airily modern neighborhood of Milan, they dissected their cultures."

A Matter of Equal Career Opportunities

"As women advanced in education levels and career tracks over the past few decades, Norway moved aggressively to accommodate them and their families. The state guarantees about 54 weeks of maternity leave, as well as 6 weeks of paternity leave. With the birth of a child comes a government payment of about 4,000 euros. State-subsidized day-care is standard. The cost of living is high, but it is assumed that both parent will work; indeed, during maternity leave a woman is paid 80% of her salary. 'In Norway, the concern over fertility is mild,' Aassve told me. 'What dominates is the issue of gender equity, and that in turn raises the fertility level. It's an issue of making sure that women and men have equal rights and opportunities. If men take leave after the birth of a child, the woman can return to work for part of the time.'

"What Aassve found in Italy was different. While Italian women tend to be as educated as Scandinavian women, about 50% of them work, compared with between 75% and 80% in Scandinavia. Despite its veneer of modernity, Italian society prefers women to stay at home after they become mothers, and this the government reinforces. There is little state-financed child care, and most newly-weds still find homes close to one of both sets of parents, the assumption being that the extended parents will help raise the children. But this no longer works as it once did. 'As couples tend to delay childbearing, the age gap between generations is widening, and in many cases parents, who would be the ones relied on for child care, themselves become the ones who need care.'

"The superficial commitment of southern European countries to modernity, to a 21st-century life-style, is fatally at odds with a view of the family structure rooted in the 19th century. [If it corresponds to living realities], it should apply to other parts of the world, should it not? Apparently it does. This spring, the Japanese government released figures showing that the country's under-14 population was the lowest since 1908. The world record for lowest-low fertility is right in South Korea, at 1.1. These are societies still rooted in the tradition where the husband earns all the money. Things have changed, not only in Italy and Spain, but in Japan and Korea, society has not adjusted. Western Europe, then, is not the isolated case that some make it out to be.

"Which brings us to a sparkling exception. Last year the fertility rate in the US hit 2.1, the highest it has been since the 1960s, and higher than almost anywhere in the developed world. Factor in immigration. and you have a nation that is far more than holding its own in terms of population. In 1984 the US Census Bureau projected that in the year 2050 the US population would be 309 million. In 2008 it's already 304 million and the new projection for 2050 is 420 million.

"According to Carl Haub of the Population Reference Bureau in Washington, there is no single explanation for the relatively high US fertility rate. The old conservative argument – that a traditional working husband and a stay-at-home – wife family structure produces a healthy, growing population – doesn't apply anywhere in the US or anywhere else in the world today. Indeed, the societies most wedded to maintaining that structure seem to be those with the lowest birthrates. The antidote in Europe has been the welfare state in which the state provides comprehensive support to the couples that want to have children. But the US runs counter to this. Some commentators explain its healthy birthrate in terms of the relatively conservative and religiously oriented nature of American society, which both encourage larger families. It is also true that mores have evolved in the US to the point where not only is it socially acceptable for fathers to be active participants in raising children, but it is often socially unacceptable for them to do otherwise."

The Allure of Greater Career Flexibility in North America

"But one other factor affecting the higher US birthrate stands out in the minds of many observers. 'There's much less flexibility in the European system,' says Haub. 'In Europe both society and the job market are more rigid.' As Hans-Peter Kohler of the University of Pennsylvania writes: 'In general, women are deterred from having children when economic cost – in the form of lower lifetime wages – is too high. Compared to other high-income countries, this cost is diminished by an American labour market that allows more flexible work hours and makes it easier to leave and then re-enter the labour force.' An American woman might choose to suspend her career for three or five years to raise a family, expecting to be able to resume working. That happens far less easily in Europe. Aasvbe put it to me this way: 'You might say that to promote fertility your society needs to be generous or flexible. The US isn't very generous, but it is flexible. Italy is not generous in terms of social services and it's not flexible. There is also a social stigma in countries like Italy, where it is less socially accepted for women with children to work. In the US that is very accepted.'

"A European Commission working document published in November 2006 concludes that 'massive and increasing flows of young migrants would be required' to offset current demographic changes. Few Europeans want that. Immigration already touches all sorts of raw nerves, forcing debates about cultural identity, citizenship tests, national canons, terrorism and tolerance. Is it even possible to increase population significantly?

"There are those who think that 'lowest low' is in itself not as looming disaster, but a challenge, and even an opportunity. The change that's required is not in breeding habits, but in thinking habits.

"One day in March, I was standing on a platform at the top of a smokestack attached to a defunct sausage factory in the German city of Dessau, looking out on a ragged urban landscape: derelict factory buildings, brick homes and shops, a railroad track snaking through a swath of grass and dirt. Even the brilliant spring weather didn't improve the view. But the bearish middle-aged man beside me was full of enthusiasm. He waved his arm expansively, indicating a distant tree line. 'From here on you see the city is embedded in a protected nature area,' he said through an interpreter. 'We will bring that into the city.'

"Listening to Karl Groeger, director of the city's department of building is disorienting; where local politicians are supposed to cheer development, he was standing in the midst of the city's industrial infrastructure and saying in effect: 'This will all be wilderness.'"

Bringing Nature into Cities in Germany to Replace the Missing Population

"But where Rocco Falivena went natalist in an attempt to confront the issue head-on, a consortium of 17 cities in this part of Germany has adopted a more innovative strategy. A decade or so after the fall of the Berlin Wall, politicians and town-planners were forced to realize that the growth they were expecting with the turn to capitalism and representative government weren't coming. They were in the crosswinds of two European phenomena; the economic malaise of the former and plummeting birthrates across the continent.

"It so happens that Dessau is the city where in 1926, the architect Walter Gropius planted the Bauhaus school of design, which embraced – and to an extent defined – Modernism and tried to mesh design and architecture with the ways people lived and worked in the 20th century. 'Nothing seemed more logical to us than to remember the 1920s and Gropius and the Bauhaus,' said Karl-Heinz Daehre, minister of land development and traffic for the province of Saxony-Anhalt.

"The current director of the Bauhau Institute, Omar Akbar, who was born in Kabul, Afghanistan, and immigrated with his parents to Germany as a small boy. He talked about the high-flying ideals of Gropius and his colleagues, and how their approach to design was so revolutionary it became politically dangerous (it was considered 'unGerman' by the Nazis).

"Akbar said that after officials approached him, he came to see the demographic changes of Europe as a renewed opportunity for the Bauhaus Institute, a chance for it to play a role in defining the modern. 'We said to the government of Saxony-Anhalt, "Shrinkage is a completely new phenomenon. We have to look for dealing with it."' According to some, a declining population presents certain opportunities, to change lifestyle and the environment. The plan that Akbar's team came up with was for 18 cities in the region (two cities now share one government) to submit to an exhaustive process under the direction of Bauhaus planners and, by the year 2010 to come up with long-term redevelopment strategies appropriate to each – to find a way for each city to shrink constructively.

"Dessau itself had two distinctive features. One is that it is surrounded by protected national forest. The other is that it has no town centre (80% was of the city was destroyed in WWII) and thus has no core. The plan, therefore, calls for demolishing under-used sections the city and weaving the nature on the periphery into the centre to create 'urban islands set in a landscaped zone. That will make the remaining urban areas denser and more alive.' The city has lost 25% of its population in recent years. That means it is 25% too big.

"This notion-embrace shrinkage to revitalize your economy, rather than trying to coax woman to have more babies is, according to more than a few observers of the European scene, the right tack."

Has this provided a way out for our world that has borrowed from the deadliest tool in the mathematician's chest – the mathematics of derivatives of growth to infinite degrees of acceleration to evaluate the products of our financial sector? That is a knot that is still going to take an immense amount of effort to unravel.

Society will have to bring accountants and central bankers into the team to pursue the Bauhaus pattern, translating into terms of accountancy and central banking what can be done.

Indeed, this excellent essay in the *Times* of Russell Shorto can be read as a conclusive dismissal of equilibrium theory and its notion of ever accelerating growth in a shrinking environment. This is arrived at by an illiterate use of mathematics with derivatives claimed to derive the future population data from that of the past with bogus accountancy that does not even treat the money spent to induce women to bear children or the mounting expenditures to put people at peace with their shrinking families, or of reconciling of the countryside with the retreating urban sprawl that reflects the diminishing population in Europe. It is impossible to read this excellent essay without concluding that the gifts of prophetic accountancy that is supposed to make it possible to predict a growing rate of profit and population down the line forever, is nonsense. Shameful that it should still be taught in most universities throughout the world.

William Krehm

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The Curse of Uninsurable Insurance

As so often it is to Gretchen Morgenson that *The New York Times* assigns its most cutting debunkings of official economic policy (10/08, "Naked Come the Speculators"): "Reining in the runaway freight train otherwise known as the credit default swap market is a rising priority for regulators who oversee banks and insurers. It's a good thing, too, given the secretive nature of the swaps, the losses side of the market: $62 trillion in default insurance is outstanding, with a fair value of $2 trillion at the end of 2007.

"One of the positives that heightened regulatory interest will bring to this huge market is a push to make participants more scrupulous about assigning proper values to their credit insurance stakes. This may be a rude awakening for many players….

"Credit default swaps, known as CDSs, allow insurance to hedge against possible default by an issuer whose debt the insured holds. If a default occurs, the party providing the credit protection – the seller – must make the buyer whole on the amount of insurance bought.

"Initially, this market was intended to make hedging a corporate bond position easier. But speculators who don't hold bonds now dominate the market, using the swaps instead to wager on a company's health or the prospects of a securities portfolio. In Wall Street parlance, these investors would be characterized as trading the contracts 'uncovered' or 'naked.'

"With defaults rising, companies that sold default insurance are getting hammered. When it announced its second-quarter results this week, the American International Group, the giant insurance company took a $5.6 billion markdown on the CDSs it wrote on mortgage-related instruments. AIG hasn't closed the positions, and the write-downs could turn into a gain if defaults are fewer than anticipated. Since the credit crisis, began, AIG has written down its mortgage-related CDS position portfolio by $25.9 billion."

Like a Mammoth Crap Game about Life Crises of the Nation

That shows how iffy insurance of what may be basically simply uninsurable can be. On the other side, it is can be retirement funds that may depend on the insurance being there effectively to guarantee means of human survival. The contrasts between the two matters that have been put together is daunting. As though the funds that have been collected against ailments, job losses, or other life crises had been invested at the "insurer' end in a mammoth crap game.

"Those who bought credit insurance as a speculation (hedge funds especially) have been joyously marking up their stakes to reflect the rising defaults. But the recent unwinding of a big insurance stake – bought by Merrill Lynch to cover potential defaults on risky mortgage-related collateralized debt obligations it held – suggests that such optimism may be overdone. Write-down at these institutions may be imminent.

"At the urging of Eric R. Dinallo, New York's insurance superintendent, Merrill Lynch agreed two weeks ago to unwind $3.7 billion of insurance it had bought on the mortgage-related obligations. Merrill received $500 million from XI Capital to close out the insurance contracts that one of its former subsidiaries, Security Capital Assurances, had written.

"There are several remarkable elements to the agreement. First was its valuation: only about 13 cents on the dollar. Because the value of the mortgage obligations covered by the insurance had crashed, it was shocking that the insurance was not worth far more than that."

That gives you a whiff of the real value behind the puffed up swaps insurance taken so earnestly [by] our overblown institutions today. But back to Morgenson. "These deals are only as good as the party on the other side, and when Security Capital's crucial credit rating was cut to junk earlier this year, the potential that the company would pay out on the arrangement dimmed.

"'The Merrill deal with XL, therefore gives market participants an honest evaluation of credit insurance written on junky mortgage-related securities in the default swap market, something that has been missing in the default swap market. The Merrill deal also represents a template for future arrangements intended to unwind CDSs,' Mr. Dinallo said."

It is such realistic light rays beamed into the pitch-dark cellars of high finance these days, that explain the growing pessimism taking over financial markets throughout much of the world.

Returning to Morgenson, once more: "Of course, not every swap should be valued at 13 cents. Because each contract covers a different security or pool of bonds with different default probabilities and maturities, they vary significantly. Indeed, on Aug. 1, the Ambac Financial Group, another bond insurer, unwound $1.4 billion in credit insurance it had written on mortgage-related securities at 61 cents on the dollar.

"Still, Mr. Dinallo said, the valuations of CDSs remain absurdly optimistic on both the books of the bond insurers who wrote them and of the companies who bought them. As regulators in this partnership, he gets to see both parties' hands."

Light into the Pitch-dark Cellars

"'The Merrill deal came together,' Mr. Dinallo explained, because Security Capital Assurance could have been threatened with a regulatory takeover had it been required to pay Merrill in full on the insurance. One reason Merrill came to the table was that it was afraid it would get no payment at all on the policy. It is easy to see why Mr. Dinallo wants these swaps off of insurers' books. As of last September, bond insurance had written some $656 billion in credit insurance on structured finance products. Some $126 billions of that covers the kind of mortgage thingamabobs Merrill was trying to protect. Yet the insurers' resources to pay those claims stood at $54 billion….

"As the sheriffs begin to confront the CDS cowboys, more losses are bound to show up in this Wild West. But a silver lining to the credit cloud we've been under for the last year does seem to be taking shape. Regulators are once again regulating. And we can bury for good the fantasy that financial market participants are able and willing to police themselves."

There Morgenson – or may it have been the editor's pen? – is by far too optimistic. You would have to introduce serious double-entry bookkeeping openly and fully into the government books, and Washington did so for capital investments reluctantly, under a misleading heading only in 1996. At the time the banks of the North American Free Trade Alliance just missed bringing down the financial firmament by bailing out the banks from their real estate and other gambles in the 1980s by allowing them to load up with government bonds of developed countries, with no down payment, because they were supposedly "risk-free." At the same time to allegedly to "lick inflation," the Bank for International Settlements – the war-room for the deregulation of the world's banks based in Switzerland – raised interest rates sky-high. What BIS and the world's central banks that ran it overlooked was that the higher interest rates would bring about a collapse in the market prices of bonds issued earlier and hence having lower coupons. When this threatened to bring the down the financial heavens crashing, the Clinton Government surreptitiously brought in accrual accountancy. Instead of writing off government investment in physical infrastructures as it did the money spent to finance it, it had done so in a single year, so that it left a government deficit on the books that in reality was not there.

Obviously, government assets carried on the government books at a token dollar invited the privatization of valuable government property in juicy deals. Moreover, putting the government assets even after they were recognized on the books – as the American government still does as "savings." This confuses the bookkeeping still more since "savings" implies assets in cash form or readily convertible into cash. That is not the case of government assets that could consist of buildings or highways and ports a century old.

That, moreover, still leaves out of the accountancy the ever greater investments the state must make in human capital, education, health, social services that was briefly recognized in the 1960s, based on the remarkably recoveries of both Germany and Japan as key exporters from the physical devastation of the Second War. The amazingly rapid recovery of these two defeated countries as exporting powers was taken as proof that investment in human capital was the most productive investment a government can make. Notwithstanding which, human capital is still left off the books as an investment. It continues to be treated a current expenditure.

All of which would suggest that, rather than policing the accountancy of our government, we are much further than we ever were from that supposedly beatic state. The mere fact that the rate of expansion of our banking system is no longer subject to the rules brought in under President Roosevelt to get out of the Depression we have set up a system that deems it necessary to go on expanding at an ever accelerating rate eliminates means a further drive towards ever greater deregulation.

William Krehm

Is Learning by Book Bygone?

As an ex-Marxist, I have been deeply impressed by the extent to which our greatest thinkers are unconsciously given to mimicking in their social thinking what was happening with the basic technology of their society. I could not help grasping that Marx – for all his classical erudition – could not help reflecting in this underlying notion of social progress the grand railway-building age in which he lived. The iron railways stopped at predetermined stations to end up at the grandiose terminal – socialism – where everybody descends, happy to have reached their final destination.

In a not dissimilar relationship. *The New York Times* (27/07, "Literacy Debate: Online, R U Really Reading?" by Motoro Rich) reports: "Berea, Ohio – Books are not Nadia Konyk's thing. Her mother, hoping to entice her, brings them home from the library, but Nadia rarely shows any interest.

"Instead, like so many other teenagers, Nadia, 15, is addicted to the Internet. She regularly spends at least six hours a day in front of the computer here in this suburb southwest of Cleveland.

"A slender, chatty blonde who wears black-framed glasses, Nadia checks her e-mail and peruses myyearbook.com, a social networking site, reading messages or posting updates, on her mood. She searches for music videos on YouTube and logs into Gaia Online, a role-playing site where members fashion alternate identities as cutesy cartoon characters. But she spends most of her time on quizilla.com, reading and commenting on stories written by other users and based on books, television shows or movies.

"Her mother, Deborah Konyk, would prefer that Nadia, who gets As and Bs at school, read books for a change. But at this point, Ms. Konyk said, 'I'm just pleased that she reads something anymore.'

"Children like Nadia lie at the heart of a passionate debate about just what it means to read in the digital age. The discussion is playing out among educational policy makers and reading experts around the world, and within groups like the National Council of Teachers of English and the International Reading Association.

"As teenagers' scores on standardized reading tests have declined or stagnated, some argue that the hours spent prowling the Internet are the enemy of reading – diminishing literacy, wrecking attention spans and destroying a common culture that exists only through the reading of books.

"But others say the Internet has created a new kind of reading, one that schools and society should not discount. The Web inspires a teenager like Nadia, who might otherwise spend most of her leisure time watching television to read and write.

"Even accomplished book readers like Zachary Sims, 18, of Old Greenwich, Conn., crave the ability to quickly find different points of view on a subject and converse with others online. Some children with dyslexia and other learning difficulties, like Hunter Gaudet, 16, of Somers, Conn., have found it more comfortable to search and read online.

"At least since the invention of television, critics have warned that electronic media would destroy reading. What is different now, some literacy experts say, is that spending time on the Web, whether it is looking up something on Google or even britneyspears.org, entails some engagement with text."

Setting Expectations

"Few who believe in the potential of the Web deny the value of books. But they argue that it is unrealistic to expect all children to read *To Kill a Mockingbird* or *Pride and Prejudice* for fun. And those who prefer staring at a television or smashing buttons on a game console, they say, can still benefit from reading on the Internet. In fact, some literacy experts say that online reading skills will help children fare better when they begin looking for digital-age jobs.

"Some Web evangelists say children should be evaluated for their proficiency on the Internet just as they are tested on their print-reading comprehension. Starting next year, some countries will participate in new international assessments of digital literacy, but the United States, for now, will not.

"Clearly, reading in print and on the Internet are different. On paper, text has a predetermined beginning, middle and end, where readers focus for a sustained period on one author's vision. On the Internet, readers skate through cyberspace at will add, in effect, compose their own beginnings, middles and ends.

"'Young people aren't as troubled as some of us older folks are by reading that doesn't go in a line,' said Rand J. Spiro, a professor of education psychology at Michigan State University who is studying reading practices on the Internet. 'That's a good thing because the world doesn't go in a line, and the world isn't organized into separate compartments and chapters.'

"Some traditionalists warn that digital reading is the intellectual equivalent of empty calories. Often, they argue, writers on the internet employ a cryptic argot that vexes teachers and parents. Zigzagging through a cornucopia of words, pictures, video and sounds, they say, distracts more than strengthens readers.

"Last fall the National Endowment for the Arts issued a sobering report linking the flat or declining national reading test scores among teenagers with the slump in the proportion of adolescents who say they read for fun. 'Whatever the benefits of newer electronic media,' Dana Gioia, the chairman of the NEA, wrote in the report's introduction, 'they provide no measurable substitute for the intellectual and personal development initiated and sustained by frequent reading.'

"Children are clearly spending more time on the Internet. In a study of 2,032 representative 8 to 18-year-olds, the Kaiser Family Foundation found that nearly half used the Internet on a typical day in 2004, up from just under a quarter in 1999. The average time these children spent online on a typical day rose to one hour and 41 minutes in 2004, from 46 minutes in 1999.

"'Learning is not to be found in a printout,' David McCullough, the Pulitzer-Prize-winning biographer said in a commencement address at Boston College in May. 'It's not on call at the touch of a finger. Learning is acquired mainly from books, and most readily from great books.'

"Reading skills are also valued by employers. A 2006 survey by the Conference Board, which conducts research for business leaders, found that nearly 90% of employers rated reading comprehension as 'very important for workers with bachelor's degrees.' Department of Education statistics also show that those who score higher on reading tests tend to earn higher incomes.

"Critics of reading on the Internet say they see no evidence that increased Web activity improves reading achievement. 'What we are losing in this country and presumably around the world is the sustained, linear attention developed by reading,' says Mr. Giaia of the NEA. 'I would believe people who tell me that the Internet develops reading if I did not see such a universal decline in reading ability and reading comprehension on virtually all the tests.'

"Nicholas Carr sounded a similar note in 'Is Google Making Us Stupid?' in the current issue of the *Atlantic* magazine. Warning that the Web was changing the way in which he – and others – think, he suggested that the Web was changing the way he and others – think, he suggested that the effects of Internet reading seems extended beyond the falling test scores of adolescence. 'What the Net seems to be doing is chipping away my capacity for concentration and contemplation,' he wrote, confessing that he found it difficult to read long books."

But hadn't Marshall McLuhan said it a half century or so sooner and better when he got the ad profession hysterical with hopes and earned himself sneers from the philosophers when he uttered the immortal five words: "The Medium is the Message." And is it not a fact that for crackerjack we in our personal and professional lives are ever more prone to imitate the prose as it appears on the Internet in colour and cartoon rather than the staid books of the great classics. Rather getting your attention by plunging their elbows into your eye, these staidly await their turn to be read on the library shelves of the world.Think for a moment about the soliciting calls directed by tele-advertisers from India speaking in rehearsed American accents and timed for your dinner hour – the ultimate dividend that we are receiving from Globalization and Deregulation.

The Blinders of High Tech

That was supposed to make us vastly freer and prosperous enough to reinforce our ever expanding economic booms with a few military options based on a failure to have learned of the fate of would-be-conquerors in Afghanistan from Alexander the Great to the Brits and the Soviets. Wouldn't you think that a touch of Google looking up the division of the would-be conquerors of Afghanistan from those who had the sense to withdraw and those – like the Soviet Russians who hadn't. Wouldn't the Pentagon have better served both Wall Street and the US plebs if they had consulted Google rather than depending on President Bush's book-nurtured knowledge of the history of some 4,000 years.

However, there are words of warning.

"Neurological studies show that learning to read changes the brain's circuitry. Scientists speculate that reading on the Internet may also affect the brain's hard wiring in a way different from book reading.

"The question is, does it change your brain in some beneficial way?' said Genevieve F. Eden, Director of the Center for the Study of Learning at Georgetown University. 'The brain is malleable and adapts to its environment. Whatever the pressures are on us to succeed, our brain will try and deal with them.'

"Some scientists worry that the fractured experience typical of the Internet could rob developing readers of crucial skills. 'Reading a book, and taking the time to ruminate and make inferences and engage the imaginational processing, is more cognitively enriching, without doubt, than the short little bits that you might get if you're into the 30-second digital model,' says Ken Pugh, cognitive neuroscientist who has studied brain scans of children reading.

"Or in the words of Zachary Sims, 18, of Old Greenwich, Conn., an accomplished book-reader craves the ability quickly to find different points of view on a subject and converse with others online, who often stays up until 2 or 3 in the morning reading articles on the Internet on technology or politics. 'They may not be pedigreed academics. They may be someone in their shed with a conspiracy. But you would weigh that?'"

If it were only that simple – both because conspiracy theories relating to the Twin Towers job as self-inflicted particularly has been irresistible to many online dependents. Unfortunately such conspiracy theories are more than balanced by the cleansing of economics courses throughout the academic world that have systematically deprived their staff the basic lessons of the 1930s, World War II and at least 20 years of considerable prosperity thereafter. Had this not happened the world would not be in the pangs of the subprime credit crisis today. You have then "conspiracy" theorists who are prepared to trade in views that may have 5% probability, if that, of being true for views that the Bushes themselves destroyed the Twin Towers.

What our merry conspiratorial theorists are doing then is trading a 100% certainty about legislation still on the books, for a romantic stretch of an overactive, if bone-lazy imagination about the Twin Towers job being self-inflicted. But such is the romanticism that the Internet can encourage that such idiotic trades of credibility can be found on the Internet without looking for them.

William Krehm

Our Recession Like Our Boom is Becoming a Multistoreyed Affair

Like the late boom, the Depression descending upon us, too, is a multi-storeyed affair. There is of course, the sudden shortage of deals that the banks could do themselves or act as financiers or advisers for hefty fees. Now, these deals having disappeared, and the banks are left increasingly with just plain banking. But not just plain banking, for a great amount of their depositors' money has gone to finance collateral subprime mortgages and other investments, carelessly thrown together because the objective was to pass them on via the "bankers' exit" – i.e., resell to "bigger fools." But even though unloaded on unsuspecting investors, much of the banks' own capital, and much of the multiple of bank credit is supported only by deposits left with the banks and often far exceeding the banks' own capital. Accordingly, if the heavens suddenly prove unfriendly, the banks cannot pass on the bogus investments. Yet in putting together such investments, the frequent absence of the real creditworthiness of the borrower was considered an "efficiency" since it eliminated further investigation of the mortgagor.

Let me explain the term "collateralized." If you borrow cash from the bank or any other source, what you get is backed by the credit of the government. That backing would include not only the powers of taxing any wealth in the nation, and hence the education, skills and talents, the natural resources of the country. So while the government may incur debt, its debt – assuming that it is reasonably well run – is different from any other debt. For since 1971 in the US and hence in most of the world, gold ceased being recognized as the legal tender of the land, and only central government debt took over that role.

That makes it very important to recognize that debt of the central government is different from any other debt. It is not a negative thing and should not carry a negative sign before it as does all private debt, but should really have a very positive sign before it.

If you find that a daring statement to make, let me draw your attention to two rather important details. If you examine the money of any country issued over the past almost forty years, you will find that it does not promise as it did up to then to deliver the amount of money in gold or silver as government bills did before then. It simply bears the laconic statement this is five ten, twenty dollars or whatever. Nothing further is promised nor can be delivered. That's the end of the line. We have progressed beyond the age of commodity money, and entered the age when society through its government provides the credit that serves as legal tender.

Bear with me, because the most important detail about our money system and hence about our economy is coming up. If you think that I am stretching the point, let me add a further detail: if our government used elementary double-entry accountancy there would be no net debt of the government. There would be no need for special positive signs to replace the misleading negative sign to remind us that there was a positive asset to offset the debt incurred. There would be a legitimate positive sign before a quantity that in fact in many cases is likely to appreciate, i.e., increase in value.

That is what double-entry bookkeeping is about – every time there is a transaction, two entries are made in the ledger – the money spent to acquire the asset, borrowed or accumulated in advance and the depreciated value of that capital asset acquired by spending that money.

The Fraud of "Cash Accountancy"

But it was the practice of governments to record the money spent to acquire the capital assets very carefully, but the asset acquired with it was written off in a single year and carried at a token dollar. Naturally that presented a very distorted picture of the state of government finances. First of all, with government in constant, and ever deeper debt as shown on its books, that meant there was apparently no money for social services, education, to take care of the ailing, aged or needy. But even more – if you carried a government asset at a token dollar on the government books, you could privatize it at a thousand or ten thousand times that amount and lease it back to an enterprising well-connected deal-maker at vastly below its true value. That is being done on a grand scale at the present time.

In this way the Ontario Hydro Electric, which was brought into existence by a Conservative government about a century ago was privatized in this way. As was the Canadian National Railways – to a former leading civil service official – just the sort of thing that has been done in post-Communist Russia.

Even in Britain where Maggie Thatcher brought privatization into status as a fine art, the government after selling off railways and other public utilities for a song, eventually learned to retain an interest so that the government could share in the profit of follow-up sales after the initial partial privatization had ascertained its market value. In 1996 in the US and in 2002 in Canada, double-entry accountancy was finally brought in for the government's *physical* investments.[1]

Now to complete the picture of the abuse of non-accountancy used by our government, only one further thing must be added. In the 1960s an economist at the University of Chicago, Theodore Schultz, had been one of the hundreds of young economists sent by Washington to Germany and Japan to study the destruction of the war, and to predict how long it would take before these countries could once against become the formidable competitors on the world market that they had been. A couple of decades later, Schultz wrote that it was amazing how wide of the mark he and his colleagues had been in their forecasts. The reason: they had concentrated on the physical destruction and overlooked the detail that the highly educated workers and administrative personnel had come through the war essentially intact. From that he concluded that the most productive of investments governments could make was in educating and training their population. Not only should that be regarded as capital to be depreciated, but the period of depreciation is longer than that of almost any physical investment. Well-educated, healthier, and better adjusted parents are likely to have families that share these advantages, which implies that the depreciation of human capital can surpass the generation in which it is lodged. Bring in the concept of capital investment to the human investments of the government and you will have no need for a special negative sign to set of the debt of government. Treat such as the investment it is, in fact, and it will appear on your books as a positive – the most positive item on the government books.

Now before we go on to a few particulars, let me point out that since the debt of the government is the only legal tender that exists today, it is important to allow no lesser, more dubious collateral to get between the government and its debt. Once government debt mingles with private commercial or investment debt – especially in an economy dedicated to endless growth, globalized and deregulated, government – credit will become itself debased and polluted. When that happens the legal tender of the land becomes subprime.

We Are in the Shadow of Subprime Legal Tender

Today, due to the mania for compulsive ever accelerating growth, all sort of dubiously stretched credit, collateralized, i.e., supported by securities of questionable quality with the security behind them sadly shrunken to reflect the fall in housing values, have brought countless banks themselves to grief.

All this has now turned around to bite the banks in their basic banking function of lending out an ever greater multiple of the deposits they has taken in, plus the cash reserves of the other "financial pillars" that the banking laws drawn up under Roosevelt barred banks from becoming involved with. Because the Bank of Canada was nationalized in Canada in 1938 when our federal government bought out the 12,000 original private shareholders, the interest paid by the federal government on any loan it obtains from the central bank comes back to it substantially as dividends. That is another way of saying that such financing is practically interest-free. There is provision for the provincial government, too, to borrow money from the Bank of Canada, but since they are not shareholders of the Bank, they will not get back the interest they pay the banks as dividends. However, there is elaborate provision in the *Bank of Canada Act* section 18, for the provinces as well as the federal government to borrow from the central bank. Even municipalities may do so, but they would require the guarantee of either the federal or provincial governments. That is true of any corporation, and the municipalities are corporations.

Such is the tale that *The New York Times* (28/07, "Worried Banks Sharply Reduce Business Loans" by Peter S. Goodman) has to tell: "Banks struggling to recover from multibillion-dollar losses on real estate are curtailing loans to American businesses, depriving even healthy companies of money for expansion and hiring.

"Two vital forms of credit used by companies – commercial and industrial loans from banks, and short-term 'commercial paper' not backed by collateral – collectively dropped almost 3% over the last year, to $3.27 trillion from $3.38 trillion, according to Federal Reserve data. That is the largest annual decline since the credit tightening that began with the last recession, in 2001.

"The scarcity of credit has intensified the strains on the economy by withholding capital from many companies, just as joblessness grows and consumers pull back from spending in the face of high gas prices, plummeting home values and mounting debt."

Without Deregulation. and Globalization, and the invasion of the other "financial pillars – brokerages, insurance and mortgage firms" this could not have happened.

But let's resume our quotation. "'The second half of the year is hot,' said Michael T. Darda, chief economist at the trading firm MKM Partners in Greenwich, Conn., who was until recently optimistic that the economy would continue expanding. 'Access to capital and credit is essential to growth. If that access is restrained or blocked, the economy takes a hit.'

"Companies that rely on credit are now delaying and canceling expansion plans as they struggle to obtain finance."

A Sad Tale between a Bank and a Good Client

"Drew Greenblatt, president of Marlin Steel Wire Products, figured it would be easy to get a $300,000 bank loans to finance a new robot for his factory in Baltimore.

Editors Should Read What They Publish

Sustainable Economics is a valiant monthly publication that has for many years appeared as the *Green Party Newsletter* of the Monetary Reform Policy Working Group of the Green Party of England and Wales. Most of its contents are reprints from other sources, and by far the greatest of these sources has been *Economic Reform,* which Brian Leslie, editor of *Sustainable Economics,* receives at the same time that *ER* goes to press.

In the issue of his publication of August 2008, there was a short note of mine in which I clarified some details regarding the achievement of Gerald G. McGeer, who persuaded William Lyon Mackenzie King to nationalize the Bank of Canada. In this proposed monetary reform he not only antedated John Maynard Keynes by several years, but went far beyond anything Keynes ever reached. At the end of my note I was surprised to find the following note: "[McGeer in fact was arguing that the government should create and control all of the national money supply. BLJ]"

This, of course, does not correspond to the facts as set forth in a longer article on the phenomenon of Gerald G. McGeer that was carried in the lead article in COMER of October 2007 and reproduced in *Sustainable Economics.*

I quote from the McGeer book, *The Conquest of Poverty*, as carried in the lead article by me on McGeer in *Economic Reform* of October 2007 and carried in *Sustainable Economics.* A single passage should suffice to show how dreadfully off base the item in *Sustainable Economics* is.

The following is a direct quote from *The Conquest of Poverty:* "No government need suffer bankruptcy while its powers in the realm of currency and credit remain unused. To save itself from destruction by the dictatorship of the Money Power, democratic government must establish a national banking system. In making the change, it should be recognized that national and commercial banking are and should be recognized and should be treated as separate and distinct functions in the monetary system. The national banking system should be confined in its operation in the creation, issue and regulation of the domestic and international medium of exchange necessary to maintain government and commerce of the nation. The merchant banking system should be confined to the business of serving the private, commercial needs of the nation. The former is essentially a public enterprise, while the latter is a normal part of the private enterprise of a capitalistic system."

You could not state the matter more clearly than McGeer did in these lines. I have always known Bryan Leslie as an honourable man, and am confident that he will make the appropriate correction.

W. Krehm

His company, which makes parts for home appliances, is growing and profitable, His expansion would add three new jobs in an economy hungry for work.

"But when Mr. Greenblatt called the local branch of Wachovia – the same bank that had been aggressively marketing loans to him for years – he was distressed by the response.

"The exact words were: 'We're saying no to almost everybody,' Mr. Greenblatt recalled [replying]: 'This is why God made banks, for this kind of transaction. This is going to slow down the American economy.'

"Earlier this year, credit extended by banks to companies and consumers was still growing at double-digit rates compared with three months earlier, according to analysis of Federal Reserve data done by Goldman Sachs. By mid-June bank credit was declining at an annualized rate of more than 6%.

"That is a drop of nearly $150 million, an amount much larger than the value of the tax rebates the government has sent to households this year in an effort to spur economic activity.

"Financial industry executives say tighter credit from major banks represents a swing back to a realistic assessment of risk, after years of handing out money with abandon. Those practices produced a mortgage crisis whose losses could reach $1 trillion by many estimates.

"'Before, they wouldn't verify income and they were loose on the valuations of collateral,' said John W. Kiefer, CEO of First Capital, a private commercial lender. 'It's preservation for many at this point. It is survival.'

"But the immediate impact is simplifying the troubles with the economy. The Federal Reserve has been lowering interest rates aggressively to make money flow more loosely to spur economic activity.

"The financial system is not going along: As banks hold on to their dollars, mortgage rates are climbing. So are borrowing costs for corporations.

"'There's been a lot of disruption in the credit market, and a lot of traditional lenders have really tightened up,' said Gregory Goldstein, president of Macquarie Equipment Finance, which leases computer gear and other technology to companies. 'Before some of the standards they lent on were weak, but we think they have overshot and gone too far on the other end.'

"No loan meant one fewer order in Chicago that makes the robot, Mr. Greenberg wants to buy, and fewer hours for workers there. It meant less business for the truck driver who would have hauled the robot to Baltimore.

"Mr. Greenblatt eventually got oral approval for the loan, after more than a week. He was still waiting for the money at the end of last week.

"Wachovia, which lost $8.9 billion in the second quarter, declined to discuss the loan. But the bank confirmed that it has been reducing its lending in troubled areas of the economy.

"Still, Wachovia's commercial and industrial loans grew by 13% in June compared with the prior year. But recent signs suggest that tight lending is spilling from housing into other areas of the business world. Companies with solid credit and profitable businesses can generally still get loans, but rates are higher and waiting times are longer.

"According to a survey of senior loan officers conducted by the Federal Reserve in April 55% of American banks tightened lending requirements for commercial and industrial loans to large and middle-size companies – up from about 30% in the previous survey in January. About 70% said they have made such loans more expensive."

William Krehm

1. See the review of Paul Hellyer's lastest book on page 17.

Uncollateralized Commercial Debt Was the First to Strike Out

It came as an utter surprise to me and to my aged memory, but there it was in an article of mine in the May, 2002, *Economic Reform* entitled "The Collapse of a Great Faith." It quoted from *The Wall Street Journal* (28/03/2, "A Dwindling Supply of Credit Plagues Corporations" by Gregory Zuckerman) which to my immense surprise dealt with commercial and no longer subprime credit.

This is not concerned with longer-term collateralized debt that came to the fore only when they had extended, and abused uncollateralized commercial debt where it was no long really available except at screechingly high rates. Only then did the subprime collateralized subprime debt enter the picture. That is rarely if ever mentioned these days. The villain of the piece then emerges clearly as the ever higher rates of accelerated growth of the economy imposed by Globalization and Deregulation not as an option but a necessity.

Enron is Still Embedded in Our Deregulated Morality

Quoting from the Zuckerman article in the *Journal:* "For years, the commercial paper market has served as the world's automated teller machine, spitting out a seemingly endless supply of super-low interest rates.

"But now, amid jitters caused by Enron Corp's collapse, the machine is sputtering, sending a surprising number of companies of all sizes scrambling to find money for their basic needs, from paying salaries to buying office supplies. Some are paying higher interest rates so that they can continue selling paper. But others have turned to raising debt by other, costlier means. These companies include Qwest Communications International Inc., Sprint Cos., Gap Inc., and Computer Associates International Inc.

"Last month, amid investor concerns about accounting at Tyco International Ltd., the conglomerate had to draw on a backup line of credit from its banks to come up with the cash needed to replace cheap commercial paper with the more expensive bank line. The move will cost Tyco about $400 million of additional after-tax, borrowing expenses."

"For an economy still in the tentative stages of a turnaround, the problems in the commercial paper market underscore the profound effect of Enron's collapse on the basic workings of American finance. Increasingly skittish about corporate accounting, the ultra-conservative investors who control the commercial paper market have cut back on a key source of liquidity. Economists worry that the troubles could put a lid on capital spending, as companies scramble to save cash – a move that could delay or even reverse the recovery.

"For the past 40 years the massive commercial paper market has been a critical – almost invisible – lubricant for the economy. Through the commercial paper market, companies issue IOUs for critical short-term financing, lasting as long as 270 days or as short as one day. The money issued to pay for their basic needs, though in recent years it has paid for one-billion-dollar acquisitions. Commercial paper requires no collateral. It is the cheapest source of debt-financing, with rates typically several percentage points below those of longer-term bonds and loans from banks. That's because it's less risky to lend money for a short period – the chance for an unforeseen downturn is less.

"Like running water, it is missed only if it stops flowing. The market began experiencing difficulties about a year ago, as the economy slowed. Enron's collapse fuelled more worry – it caused credit rating agencies to become hawkish. Stung by criticism that both Moody's and Standard & Poor's kept Enron at investment grade until just five days before it filed for bankruptcy, the rating agencies started poring over their balance sheets, looking for companies that seem over-dependent on commercial paper….

"The fears have gotten so bad that Pacific Investment Management Co. (PIMCO), the $250 billion fund company known in the bond market for its aggressive bets, has slashed its holding of lower-tier commercial-paper to just 4% of its portfolio, down from 25% at the end of 1999.

"Last week Bill Gross, PIMCO's CEO, declared that his firm wouldn't even buy commercial-paper from General Electric Co., which had been relying on this market for about half its financing needs."

Credit Is an Act of Faith

"Big or small, commercial credit is an act of faith. Its bottom line is that someone has to believe in the trustworthiness of his fellow-man. But the creed that vice-writ-big enough becomes virtue has come upon evil times. Even the auditing profession has become the butt of ribald jokes and criminal investigation."

Collateralized debt, in the main doghouse today because if the central bank ends up loaded down with dubious collateral that has no market to appraise it, and is subprime because of the basic law of a globalized and deregulated economy is that everything must expand for the simple reason that there is an ever greater likelihood that it has been swapped in a derivative play to "insure" the lender that he will emerge unscathed because he has taken out insurance against having guessed wrong. The main villain is unbridled greed which has under Globalization and Deregulation declared the supreme virtue. But the fact is that safe debt calls for moral rather than just quantitative dimensions. And these have long since surrendered to greed growing at an exponential rate.

W.K.

To the Editor of The New York Times Magazine

In your issue of *The New York Times Magazine* of 24/8, you carried a most interesting article on [Advanced] Obamanomics by David Leonhardt. You might be interested in an important detail that seems to have escaped Mr. Leonhardt and possibly Mr. Obama himself.

"A few weeks ago, I [Leonhardt] joined him on a flight from Orlando to Chicago and began our conversation by asking about his economic approach. He started his answer, but then interrupted himself. 'My core economic theory is pragmatism,' he said. 'Figuring out what works.'

The obvious commentary that cried for insertion at this point – in the contemporary US, especially between the haves and have-not, especially those of a dark skin hue, very little.

"To understand where Obama stands, you first have to know that, for 15 years, Democratic Party economics have been defined by a struggle that took place during the start of the Clinton administration. It was the battle of the Bobs. On the one side was Clinton's labor secretary and longtime friend, Bob Reich, who argue that government should invest in roads, bridges, worker training and the like to stimulate the economy and help the middle class.

On the other side was Bob Rubin, a former Goldman Sachs executive turned White House aide, who favored reducing the deficit to soothe the bond market, bring down interest rates and get the economy moving again. Clinton cast his lot with Rubin, and to this day the first question about any Democrat is economic outlook is often where his heart lies, with Reich or Rubin, the left or the center, the government or the market.

"Obama has obviously studied this debate, and early on during the flight to Chicago he told me of a discussion with a high-powered group of economists and chief executives. He was sitting at a conference table with Rubin two seats to his left, and Reich across from him. 'One of the points I raised,' Obama told me, 'is if you just use you, Bob, and you, Bob, as caricatures, both of you acknowledge that the world is more complicated.'"

However, if you overlook the ever deeper trenches that divide our society, you will do damage to life and limb across the world.

"In practical terms, the new consensus means that the policies of an Obama administration would differ from those of the Clinton administration, but not primarily because of differences between the two men. 'The economy has changed in the last 15 years, and our understanding of economic policy has changed as well.' Furman says. 'And that means that what was appropriate in 1993 is no longer appropriate.' Obama's agenda starts not with raising taxes to reduce the deficit, as Clinton ended up doing, but with changing the tax code so that families making more than $250,000 a year pay more taxes and every one else pays far less. That would begin to address inequality. Then there would be Reich-like investments in alternative energy, physical infrastructure and such, meant both to create middle-class jobs and to address long-term problem like global warming.

"During our conversation, Obama made it clear that he considered the deficit to be only one of the long-term problems requiring immediate attention, and he sounded more worried about the others, like global warming, health care and the economic hangover that could follow the housing bust."

A Missing Solution — Double-entry Accounting

But this is the very moment when we must open every door and window to let in an exiled crucial partner in these discussions even more important than the two Bobs of the original Clinton team – double-entry accountancy.

Every new transaction is entered into the ledger of a corporation or individual twice – once recording the money laid out for the transaction and that is "amortized" over a period more or less in keeping with the useful life for the capital asset acquired; and a second time the same value is entered as the value of the capital asset acquired, and that is "depreciated" over a period corresponding to its existence. In this way the role of the bookkeeper's eye over these related entries, should provide an idea of how the investment is faring.

That is enforced in the private sector – and is thus of key importance in the matter of taxation that Mr. Obama is sensitive to. But that has not been the case in the government sector. There until January 1996 the value shown in the Secretary of Commerce statistics wrote off the asset value of government capital assets in the year in which the asset was completely built or taken over, and thereafter carried at a token one dollar. Obviously, this discrepancy between the treatment of assets and liabilities, under a system of bookkeeping that was referred to "cash accountancy," produced a distortion immensely useful to certain sectors of the business world.

An apparent budgetary deficit was helpful in keeping down expenditures for social programs, and in for those engaged in securing bottom-of-the-barrel privatizations of government assets. The proper handling of government investments is referred to in accountancy circles as "accrual accountancy" or more popularly as "capital budgeting."

Its introduction in the US in 1996 and in Canada in 2002 resulted from some highly unusual circumstances.

When F.D. Roosevelt was inaugurated for his first term as president, some 9,000 US banks had already closed their doors, and one of his first moves was to declare a bank moratorium that closed every bank in the United States for a full month. The legislation that was brought in to prevent another speculative boom and bust such as that of the 1920s had as one of its key provisions that banks must not acquire interest in the non-banking "financial pillars," to wit, stock brokerage, insurance, and mortgage companies.

The reasons for that: each of these carried cash reserves for the needs of their own business. Allow the banks to acquire access to these, and they will use those reserves as money-base to which to apply the "bank multiplier" – i.e., to lend out a multiple of the cash actually kept by the bank in its coffers. Applying this process repeatedly to the results that might be described as a financial skyscraper serviced with a one-way elevator that can only rise, never go down or stand still.

This in fact, with the further application of derivative structurings and swaps, is what has brought the world economy to its knees.

Obviously, this will be confronting an inadequately prepared government no matter which candidate is elected. But that is the merest beginning of such gruesome surprises. We were somewhat encouraged to read Mr. Obama declaring: "I probably wouldn't have been so obsessed with deficit reduction."

But there is a simple positive way of handling government deficits: check your accountancy to make sure that what you consider a "deficit" in fact is not an unrecognized capital asset badly classified as just a debt by a bit of brute non-accountancy. I have mentioned that as of January 1996 the Secretary of Commerce figures introduced accrual accountancy and instead of writing off physical capital investments in a single year it does so over their probable useful life. Unfortunately that appeared under the heading of "Savings" which usually refers to cash or readily cashable assets. And here we could be dealing with buildings and bridges

The High Costs of Ignoring History

The high cost of ignoring history has been scrawled, screechingly, across the world's blackboard as rarely before. The subject, oddly enough is Afghanistan and the hazardous fate of great powers that were foolish enough to invade the difficult mountainous land peopled by hardly less difficult tribes. Over past millennia, conquerors who didn't have the gumption to withdraw in good time, found themselves devoured by the misjudged effort. Those who did, included great martial names such as Genghis Kahn, Alexander the Great, the British on three distinct occasions. Those didn't include the Soviet army, that was so debilitated from their years in Afghanistan that the regime collapsed not long after its eventually managed pull-out. And although the Americans were close observers of how the Russian armies were chewed up during their years in Afghanistan, they were unwise enough to try their hand at the same sport.

Even today the more likely candidate for the presidency of the US, Mr. Obama – we know not how or why except through an honest ignorance of history – has endorsed the policy of pulling out of Iraq, but having the US army stay on in Afghanistan. Obviously pulling out of both places would be the wisest thing to do. Failing that, getting out of Afghanistan is what history dictates.

Even the present financial problems of the United States can be traced in large part to a not dissimilar war carried on in Vietnam that so drained the US of wealth and prestige that it was no small factor in the abandonment of the gold standard by the US and through it of the world. There is nothing wrong with moving from gold to central bank credit as the legal tender of great countries. But then the government must have an understanding of the high cost in self-respect, human lives, and wealth of conducting colonial wars in lands of difficult terrain and that have progressed far beyond the acceptance of colonial status.

It should be a warning that once again the bad judgment that led the US into the Vietnamese War and the humiliating defeat and pull-out while leaving their local supporters to their fate, could hardly have improved the reputation of the lone great power of that day.

The New York Times (15/08, "US and Poland in Missile Deal" by Thom Shanker and Nicholas Kulish) reports: "Also yesterday, the US and Poland reached a long-stalled deal to place an American missile-defence base on Polish territory, in the strongest reaction so far to Russia's military operation in Georgia.

"The deal reflected growing alarm in countries like Poland, once a conquered Soviet client state, about a newly rich and powerful Russia's intentions in its former Cold War sphere of power. Those fears were codified to some degree in what US officials characterized as unusual aspects of the final deal: that at least temporarily, US soldiers would staff missile sites in Poland oriented towards Russia, and that the US would be obliged to defend Poland in case of an attack with greater speed than required under NATO, of which Poland is a member.

"As the military and diplomatic battles played out, the relief planes swooped into Tbilisi with tons of supplies for the estimated 100,000 people uprooted by the fighting. Russian troops searched selected cities, forests and fields for military equipment left behind by Georgian forces." Associated Press, with reports from Reuters, *The New York Times*, and The Canadian Press.

More than a mere press report, the above is a model that, fleshed out and expanded, threatens to dominate our nightmares and our skies.

William Krehm

and canals more than a century old. Carried back to 1959 this brought to light another $1.3 trillion of neglected capital physical assets, and with a nudge or wink to the rating agencies this helped immensely in improving the rating of government bonds and lowering the interest it has chosen to pay the banks instead of using the Federal Reserve where it would be entitled to a far lower rate. The resulting low interest rates ensured Clinton of a second term and prolonged the high-tech stock market boom.

But we are talking not physical investments by government, but investments in human capital. That is still treated as a current expenditure rather than as a capital investment. We note that Obama spent 12 years at the University of Chicago. A once-celebrated other alumnus of that University – in the economics department – Theodore Schultz, was one of many hundreds of young economists sent by Washington to Japan and Germany to forecast how long it would be before those two defeated lands would be able to reappear once more as the formidable competitors on the world markets.

Some twenty years later, in the 1960s Schultz wrote a paper elaborating his conclusion why their prediction was so wide of the mark. It was that he and his colleagues had concentrated on the physical destruction and gave little heed to the fact that the highly educated and disciplined work force had come out of the war essentially intact. From that he concluded that investment in human capital is the most productive investment a government can make. For this he was awarded the Bank of Sweden's so-called Nobel Prize for Economics. He was celebrated and feted world-wide, until the powers that be who did not smile at spending their tax dollars for such items as education, and hence, health and social programs that would preserve the vessels in which this precious investment was stored. The name of Schultz today is rarely recognized even by economists. But his conclusion is the key missing piece to set in proper perspective the concerns about balancing budgets that have been so widespread, above all since the days of Ronald Regan.

All this certainly has a great bearing not only on Mr. Obama's future career, but of that of the United States and the world.

You may possibly wish to alert your readers of this little omission in the curriculum of our economic faculties and of Mr. Obama's otherwise brilliant campaigning.

William Krehm

Eventually Will Only Bankers Afford a College Education?

No we haven't dreamt this one up. We have read it in *The Wall Street Journal* (11/08, "Students Face Hit As Private Lending Dries Up" by Robert Tomsho): "A retreat by private-sector lenders from the market for education loans is threatening to keep out of college thousands of students in the coming academic year.

"About 10% of the nine million student borrowers in the US seek such private loans, which supplement the limited amounts available from government-aid programs. Over the past decade, as government grants and loans have failed to keep pace with rising tuitions, private-loan borrowing has increased more than tenfold to $17.1 billion annually.

"More than two dozen lenders, including Bank of America Corp. and Citigroup Inc., have stopped or curtailed private lending to students since the beginning of the last school year. On Tuesday, Wachovia Corp. joined their ranks. Ferris Morrison, a Wachovia spokeswoman, said the bank decided to stop making private loans to undergraduates after 'evaluating our organization in the current environment. Lenders have cut back on making such loans as investors have shunned the securities they rely on to raise lending capital."

So it turns out that there are no personal culprits. It is just the "system" which tends to be mistaken by those in power with the good Lord's wish on the way in which the world should be run,

But that is not quite so. Education some decades ago was recognized from the surprisingly rapid recovery of Japan and Germany from the tremendous physical destruction in World War II. From this one of the hundreds of US economists who had been sent by Washington at the end of the fighting to predict how long it would be before those two defeated countries would become once again the formidable competitors on world markets that they had been. And one of these, confronted, with the surprising spectacular comeback of the economies of those two lands, concluded that investment by governments in human capital is the most productive investment that governments can make. For which he was honoured by governments and even by central banks. Today, however, Theodore Schultz of the University of Chicago is forgotten along with his crucially important work, except by a few organizations like COMER.

It is only in the light of Schultz's appraisal of the importance of investment in education, and hence in health, and social services, that we can appraise the anti-social idiocy of allowing governments to fritter away society's resources to bailout the ever more deregulated banks to gamble bigger and better and take over non-banking financial services like insurance, mortgages, and stock brokerages, that they had been forbidden to get involved in.

The Rooseveltian Banking Laws

When F.D. Roosevelt was first inaugurated, 9,000 of the banks in the US had shut their doors. One of the first things the new president did was to declare a bank moratorium. And when the legislation to get out of the mess was finally devised, it banned banks from acquiring interests in the other "financial pillars" that I have just mentioned. That legislation made possible the Allied victory, and 20 years of a more just society that not only took care of the neglected maintenance during sixteen years of depression and war but gave us a more just and efficient society. And the key to that unprecedented stretch of increased justice between classes and more equal access to education was the legislation that confined our banks to banking. All those non-banking pillars keep cash reserves for the needs of their own businesses – to a far greater extent than banks themselves do. But the art of banking is to lend out responsibly many times the amount of legal tender – also known as cash – that it holds in its vaults. When a bank takes over an insurance company, brokerage, or mortgage company it applies the bank multiplier to the cash reserves that such forms need for their own business. This used to be 10 times the cash in their possession. So long as they did not overdo that trick, and yet be in sufficient funds to honour any check or draft that came from the owners of the deposits left with the banks, they were in good shape. But the merest suspicion that a bank had overreached itself and could not meet crucial test could start a run on all banks.

That was clear centuries ago. And indeed the troubles that have overtaken the whole financial scene from student loans, to mortgages, to insurance companies, to stock brokers, add up to one wholly *climacteric run on our financial and monetary systems.* The editor of *The Economist* of London, in round figures 150 years ago, pointed out that the mere suspicion that a single bank might be overextended was enough to start a run not only on one bank but on the entire banking fraternity. That is made simpler when all our financial systems have become of a single flesh, their credit, real or phony piled up storey-wise like skyscrapers with elevators only going up. If they dare try to descend, he whole structure crumbles.

The mathematics are those of exponential curve which is not to be mistaken with compound interest. In the exponential curve the rate of growth is such that the acceleration of that growth and the rate of increase of that acceleration to infinitely higher degrees always equals the value attained by the underlying expression itself at ever increasing speed. And that is why the subject of derivatives as a financial tool has been declared sacred and not subject to

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REVIEW OF A BOOK BY PAUL HELLYER, CHIMO MEDIA, 2003

"One Big Party — To Keep Canada Independent"

A belated unpacking of a crate of books resulting from a house-moving has put into my hands the final book of Paul Hellyer sent to me for review some three years ago – its publication date was actually 2003. It covers the world of high Canadian politics – Hellyer during a crucial stretch of the political road was deputy Prime Minister under Pierre Trudeau, and expresses very valid concerns about the slashing under the Mulroney, Chrétien, and Paul Martin governments of vital social and other services to cope with apparent budgetary deficits. These in fact were the by-product of a lack of serious accountancy rather than of cash.

Although double-entry bookkeeping is said to have been brought to Western Europe by Crusaders some thousand years ago, its absence in our government's bookkeeping – where investments in human capital are concerned still report large deficits reflecting less the lack of funds than of double-entry bookkeeping. To this day money spent on education to enable our work force to cope with such devices as computers and other high technology is written off as a current expense. Nonetheless it will increase the productivity of the work-force for years to come on an ongoing basis.

I remember when Paul Hellyer was a member of COMER a good quarter of a century ago his strange reluctance to relate many of the problems in government that preoccupied him to a woeful gap in its accountancy. Oddly enough, that blind spot has been carried forward in the present excellent work. This is all the more remarkable because accrual (a.k.a. capital) accountancy was finally introduced for physical capital investments in the United States in 1996, and in Canada in 2002.

The chain of events that led to that is itself revealing and an important link in Hellyer's otherwise well-told tale. In 1988 when the deregulated American banks had lost a major part of their capital in taking over the Savings and Loans (mortgage trusts) that they had been banned from acquiring under F.D. Roosevelt, the Bank for International Settlements – the international Basel-based war-room of banks dedicated to deregulating the private banking systems – declared the government debts of developed lands "risk-free" and thus declared banks free to load up with such government debt with no down payment. This resulted in the banks acquiring a flow of income, while BIS raised interest rates to the skies to bring what they called "inflation" down to zero – nothing less, BIS's manager declared, would do. But in their haste to get the banks out of the soup, the BIS and the central banks gathered around its knees overlooked a detail. If you shove up interest rates so brusquely, the market value of pre-existent bonds with lower coupons will collapse. And in this case the resulting anguish cut the Mexican currency off at the knees. That led to the renationalization of Mexico's banks that had only recently been privatized, and threatened a world wide banking crisis.

Accrual Accountancy Introduced in Disguise

To deal with the situation the Clinton government devised a way out of the dilemma. The banks sorely needed the coupons from the government bonds that they were able to load up on. So the US Treasury resorted to another tack. Up to that point the physical investments of the federal government had been depreciated entirely in a single year. Depreciating these capital over their useful lives would produce not only a more accurate but a vastly better balance in government accounts. And that in return picked up by the bond-rating agency, possibly with a wink and or a nudge from the Treasury drove up the return by bringing down the interest charged on the government bonds. This prolonged the high tech boom of the late 1990s and gave Clinton his second term. It also prolonged the high tech stock market boom into the high-tech bust.

By January 1996 the Department of Commerce figures after the readjustment had been carried back to 1959, revealed some $1.3 trillion of assets previously missed. However, they were published under the caption of "Savings" which they were not, since that implies cash or short-term securities readily convertible into cash. But it did the job.

The Canadian recognition of the physical capital investments of the federal government resulted in the increase of government physical assets in the amount of $50 billion. That seems understated since the ratio of 1:10 covers the proportion of the Canadian to American economies. Moreover, a more sparsely settled country as Canada is compared to the US and farther north to boot, inevitably requires more costly infrastructures than one in a gentler climatic zone.

But the net result especially when the investment in human capital is added, is bound to reveal a reasonably balanced federal budget. It is puzzling that Paul Hellyer should continue ignoring accrual accountancy, when the very government has adopted it with respect to physical capital, and its importance in the case of human capital was widely recognized due to the work of Theodore Schultz which was widely recognized in the 1960s and suddenly suppressed in academia and by the economics profession.

Nobody espousing the cause of bank reform as does Paul Hellyer in this fine booklet could be unaware of how such thought-control is managed.

William Krehm

Disturbing Reminders of Neville Chamberlain's Paper Settlement with A. Hitler

The analogy should not be drawn too closely, because a war between major powers in this advanced nuclear age could put a question mark over the survival of the human race as we know it. However, to shed light on the perverse role seeming commitments to peace can play, we need only remember Prime Minister Neville Chamberlain in 1939 returning from Germany and waving triumphantly before the cameras a piece of paper bearing Hitler's signature over his commitment for peace.

The New York Times (18/08, "How a Spat Became a Showdown" by Helen Cooper, C.J. Chivers and Clifford Levy) recounts some disturbing parallels: "Washington – Five months ago, President Mikheil Saakashvili of Georgia, long a darling of this city's diplomatic dinner circuit, came to town to push for America to muscle his tiny country of four million into NATO.

"Mr. Saakashvili, brash and hyperkinetic, urged the West not to appease Russia by rejecting his country's NATO ambitions.

"At the White House, President Bush bantered with the Georgian president about his prowess as a dancer. Laura Bush, the first lady, took Mr. Saakashvili's wife to lunch. Mr. Bush promised him to push hard for Georgia's acceptance into NATO. Mr. Saakashvili said he did not know of any other leader of a small country with the access to the administration that he had.

"Three weeks Mr. Bush went to the Black Sea resort of Sochi, at the invitation of President Vladimir V. Putin of Russia. There, he received a message: the Russian president warned that the push to offer Ukraine and Georgia NATO membership was crossing Russia's 'red lines,' according to an administration official close to the talks.

"Afterward, Mr. Bush said of Mr. Putin, 'He has been very truthful and to me. That's the only way you can find common ground.' It was one of the many moments when the US seemed to have missed – or gambled that it could manage – the depth of Russia's anger and the resolve of the Georgian president to provoke the Russians.

"How a 16-year, low-grade conflict over who should rule two small mountainous regions in the Caucasus erupted into the most serious post-cold-war showdown between the US and Russia is one of miscalculation, missed signals and overreaching, according to interviews with diplomats and senior officials in the US, the European Union, Russia, and Georgia.

"As with many foreign policy issues, this highlighted a continuing fight within the Administration. Vice-President Dick Cheney and his aides and allies, saw Georgia as a role model for their democracy promotion campaign, pushed to sell Georgia more arms, including Stinger antiaircraft missiles, so that it could defend itself against possible Russian aggression."

Not Even in Heaven Could Defence Bases be Better Covered

That was good for American world supremacy, and for reviving home business that needed markets badly. And not even in heaven itself could you expect all defence bases to be better covered.

"On the other side, Secretary of State Condoleezza Rice, National Security Adviser Stephen J. Hadley and William J. Burns, the new under secretary of state for political affairs, argue that such a sale would provoke Russia, which would see it as arrogant meddling on its turf.

"They describe three leaders on a collision course. Mr. Bush, rewarding Georgia for its troop contribution to Iraq – a per-capita ratio higher than America's own troop contribution – promised NATO membership and its accompanying umbrella of American military support. Mr. Putin, angry at what he saw as an American infringement right in his backyard, decided that Georgia was the line in the sand that the West would not be allowed to cross.

"With a vastly more confident Russia, flush with money, a booming economy and a rebuilt military no longer bogged down in Chechnya, the stars were aligned for a confrontation in which Russia could, with a quick show of force, teach a lesson to the United States, Georgia, and all the former Soviet satellites and republics seeking closer ties with the West.

"The stage for the confrontation was set in January 2004, when Mr. Saakashvili handily won the presidency after heading protests against a rigged election the previous year. He made the return of separatist areas to Georgian control a central plank of his platform.

"His young government, a small circle of men in their 30s with virtually no military experience, openly endorsed his thinking.

"Georgia increased its troop contribution to Iraq, and in return the US provided more military training. The Georgians clearly saw this as a step to building up a military that could be used to settle problems with the separatists at home.

"American officials said they repeatedly and bluntly told their Georgian counterparts that the Iraq mission should not be taken as a sign of American support, or as a prelude, for operations against the separatists.

"Nevertheless, the career foreign policy establishment worried that the wrong signals were being sent. 'We were training Saakashvili's army,' said one former senior intelligence analyst who covered Georgia at the time.

"Mr. Saakashvili proceeded against other separatist enclaves – retaking Ajaria, in 2004, and advancing high into the mountains of the upper Kodori Gorge in Abkhazia in 2006 to sweep away bands of criminals who had long controlled the place."

Russian Anger

"Russia, too, was laying down its markers, strenuously protesting the West's intent to recognize the Serbian province of Kosovo, set on independence after the long Balkan wars of the 1990s. The Russians insisted that independence for Kosovo would be a serious affront. Last February, the US and the EU, over Russia's vehement objections, recognized an independent Kosovo.

"Mr. Putin drew a parallel with Kosovo: If the West could redraw boundaries against the wishes of Russia and its ally Serbia, then Russia could redraw the boundaries of South Ossetia and Abkhasia.

"By April, before the Russians had a chance to grow accustomed to an independent Kosovo, they were being confronted with what they saw as more meddling in their backyard. On April 3, the night before the NATO summit meeting in Bucharest, Romania, Mr. Bush attended a dinner with European leaders and annoyed the Germans and French by lobbying long and hard for Ukraine and George to be welcomed into a membership Action Plan that prepares nations for NATO membership.

"Mr. Bush lost that battle, but won two others the next day that would anger Russia. NATO leaders agreed to endorse a US missile defense system based in Eastern Europe, and the Europeans said invitations to the membership plan for Georgia and Ukraine might come in a year, at the next summit.

"The next day, Mr. Bush and Mr. Putin went to Sochi. Mr. Bush had dinner with Mr. Putin and his protégé and successor, Dmitri A. Medvedev, at the Russian resort, which is near Georgia. The official said the discussion centered on the Ukraine and Georgia, and Mr. Putin warned again, against the NATO push.

"Bush administration officials have been adamant that they told Mr. Saakashvili that the US would not back Georgia militarily in a fight with Russia, but a senior administration officer acknowledged may have confused cheerleading from Washington with something else.

"In May and June, Russia increased the number of troops in South Ossetia and sent troops into Abkhazia, who Moscow said were going for humanitarian purposes, Georgian and American officials said.

"Ms. Rice traveled to Tbilisi, Georgia, in July, where aides said, she privately told Mr. Saakashvili not to let Russia provoke him into a fight he could not win. But her public comments, delivered while standing next to Mr. Saakashvili during a news conference, were far stronger and more supportive And when she brought up NATO membership, mentioning that the Bush administration had pushed for it at Bucharest, Mr. Saakashvili jumped on the opportunity to get a public commitment that the administration would bring the matter up again with NATO before leaving office.

"I understand your you are going to give a tough fight for us in December,' he said.

"Ms. Rice: 'Always, Mr. President. We always fight for our friends."

What is not mentioned in this comprehensive review is that the Americans having been trapped in the Afghan bear-trap and with the financial crisis reducing them to a somewhat diminished power they were no longer in a position to follow up – or even to utter threats to the Russians. No government understands that better than the Russians who themselves had been caught in the Afghan trap for long years that helped hollow out the Soviet might right to its final collapse.

William Krehm

Glad Tidings for CAP

Rejoice, rejoice for the Canadian Action Party can bring Canada glad tidings. The solution to our deepening economic crisis was worked out by our grandparents when they nationalized their central bank in 1938 by buying out 12,000 private shareholders at a good profit after holding the Bank of Canada shares for less than four years. That is why Canada was able to finance her part of World War II less expensively than either the US or Great Britain, by the simple device of doing more of that financing through the Bank of Canada and getting practically all the interest back as dividends on her BoC stocks. That also gave Canada a quarter of a century of well-trickled down prosperity that we had never seen before or since.

John Maynard Keynes had revealed in very crude form the secret of how that could be done and it became the law of the United States under the second President Roosevelt. Soon it was copied throughout much of the world. But as our banks healed with the rest of the economy, they came to long for the power position they had acquired in the 1920s and had brought on the Great Depression and the first Great War. But after World War II we had the *Bank of Canada Act* and the *Bank Act* that between them provided everything needed for extending these beginnings of a better, fairer society into the future. But this would seem to involve utilizing the Bank of Canada to finance government capital investment according to the Keynes formula. Instead they felt that the government should not be borrowing funds to get them out of their gambles from its own central bank at a near-zero. interest rate. And that being so, the banks mobilized their political campaign contributions to block that. They preferred the government borrowing from the very private banks they were bailing out.

Actually, to make this possible involved cooking the government's books in a way that would heavily fined if a private businessman tried to do what the government itself was doing across the board with its own investments. Until January 1996 Washington on building a bridge, a building, a battleship or a highway, carefully recorded the debt incurred and amortized it over approximately the useful life of the capital asset. But the capital asset itself, rather than being depreciated over its foreseeable useful life, was written off entirely in a single year and starting with year 2 carried on its books at a token $1. The result was disastrous. It showed a deficit that was simply not there. And it was of immense profitability for the financial sector in extracting not only interest rates from the government to get the banks out of their gambling losses, but in shoving up interest rates to suit the bogus deficits shown on the cooked government books. It mattered little that in Canada several royal commissions had recommended double-entry entry bookkeeping, the device by which every transaction of individuals, corporations or governments was entered twice, once as a negative and again as a positive entry – one showing the cost of the investment, and the other its capital value. Once entered, the two items would report their subsequent values. The Crusaders are believed to have brought back from Muslim domains such double-entry bookkeeping roughly a thousand years ago.

Even Maggie Thatcher in the UK, who ushered in an epoch of privatizations of government property from rail to energy, at rock bottom prices, ultimately devised a way of diminishing the scandals of future privatizations. By this the government sold only a portion of the asset to ascertain what a fair market value might be, but when the remaining balance of the asset was put up for sale, it would be at the market price so determined and the government had a share of the profit on the second portion sold. But not in Canada.

A Gust of Unforeseen Circumstance

However, accrual accountancy blew in a gust of unforeseen circumstance connected with the ever more embracing speculations that banks were encouraged to get involved in. And it happened with real estate mortgages, since the lessons that should have been learned from the loss of banks in mortgages brought major banks into bankruptcy in need of massive bailouts by the government. To cover their losses in financing mortgages that had been banned to the banks under the Roosevelt legislation, the Bank for International Settlements, based in Basel, Switzerland, had ruled that the debt of developed countries was "risk-free" and hence all they need do was cash the coupons of government bonds. At the same time BIS ruled that any amount of price rise that it automatically mistook for inflation had to be suppressed by raising the benchmark interest rates set by central banks high enough. As a result interest rates rose into the low 20% range. In their astonishment at what the deregulation of banking had done, BIS and all the central banks overlooked a detail. When you raise interest rates substantially, the market value of pre-existing bonds with a lower coupon drops like rocks. And that is what happened, with the BIS's effort to "lick inflation). The Mexican living standard fell fully 40% and threatened to bring on an international crisis. The US, the IMF and Canada put together a $51 billion stand-by fund which turned out not needed. Robert Rubin, Clinton's Secretary of the Treasury found a way of accommodating the interest rates, but the banks could not forgo those interest payments from the load of bonds that they had been allowed to acquire entirely on the cuff. That gave Clinton a second term, and prolonged the technological stock boom until the sell-off in the new millennium. 85% of the banks of Mexico – a staunchly nationalistic land – ended up once again sold at rock-bottom prices to foreign banks.

But, if not planned, that at least brought accrual accountancy into the government accounts in the US. Worked back to 1959 it revealed some $1.3 trillion dollars of assets in the government accounts. This started appearing in January 1996, but under the title "Savings." Of course the assets could not be considered "savings" since they could refer not to cash, but to buildings highways, bridges that could well be decades old. Deception, however, in one degree or another is an irresistible perquisite in running a government where banks are deregulated and globalized.

The Canadian government under Minister of Finance Paul Martin soldiered on opposing the insistence of the Auditor General that Canada adopt accrual accountancy, but encountered great resistance to apparently what came to be regarded by the party of Mackenzie King as seditious propaganda. Eventually a demeaning compromise was reached that brought in accrual accountancy for the physic investments of the federal government.

But that is still a major portion of government capital assets out in the cold – investments in human capital: education and training, and hence also health expenditure, and social services in general. It so happens that in the 1960s this government investment came to be recognized as the most productive investment that a government can make. And the realization of that came to economists in the most costly of experiments until that moment – the Second World War. With the war over, Washington had dispatched hundreds of economists to Germany and Japan to forecast how long it was likely to take before those two great defeated powers became formidable competitors again on the markets of the world.

Twenty years later one of these young economists, reconsidering the subsequent record concluded that the economists had missed the correct answer because they had concentrated on the *physical* destruction and paid little heed to the detail that the highly trained *work force* had come through the war practically intact. From that he deduced that the most productive of all investments was in human capital, education, and in the vessels holding that investment – health and social welfare. That won the author, Theodore Schultz, a Bank of Sweden "Nobel Prize" award. For a few years Schultz was celebrated for his discovery, and even invited by the Bank of Canada to explain the details of his work to the Bank of Canada. In actual fact the children of educated, healthy parents are likely to be more readily educated and healthier than those of uneducated people

But that was not a message that those in power wanted to hear.

Hence it is particularly important that CAP adopt that message and run with it. It will be proof that the deficit that our politicians in power and the financial forces they represent fear so much is not really a deficit, but simply non-accountancy. That is a message that we must convey to every elected representative and every aspiring politician. Unless it is effectively delivered our democracy itself is a farce.

William Krehm

Education *from page 17*
control or even free discussion at even at the world's greatest universities. It is holy terrain not to be trodden. But let us get back to the *WSJ*.

"The nonprofit Massachusetts Educational Financing Authority or MEFA, said late last month that it couldn't raise the capital for private loans, forcing some 32,000 would-be borrowers to scramble to find funds elsewhere. Some of the hardest-hit students are at for-profit schools that offer training in everything from nursing to computer programming. These schools often cater to low-income students who tend to have lower credit scores and higher loan-default rates.

"After multiple rejections from lenders, Katrina Cardin, a single mother of two from Mount Horeb, Wisc., recently landed a $3,000 loan to pay off her overdue nursing-schools bills from the summer-term. But she's still not sure how she will pay for fall classes at Southwest Wisconsin Technical College, in Fennimore, Wisc. 'I was approved for a loan with no problem last year,' she says. For many students, the private-sector turmoil could lead to delays, disruptions and fewer choices on where to attend.

"Students are being hit on another front: Many banks that are still making private loans are tightening their standards. Among other factors, lenders consider a loan applicant's so-called FICO score, a measure of creditworthiness used to rate consumers on a 300-to-850 point scale. This year, some lenders have raised that threshold by as much as 100 points, according to financial-aid administrators and industry-analysts. The hike is especially troubling for younger college students who haven't a chance to build up a good credit score.

"This could leave as many as 200,000 students ineligible for private loans this fall, says Mark Kantrowitz, publisher of Finaid.org, as Website to financial aid.

"Keiser University, based in Fort Lauderdale, Fla., with 13,000 students, says only about 25% of its applicants are getting approved for private loans these days, down from about 80% a year ago.

"Amorelle Henry, 25, has two semesters left to go of nursing school at the University of Northern Colorado in Greeley, Colorado. She borrowed about $15,000 in private loans from various lenders in each of the past two years to supplement federal grants and loans to cover her living expenses. This year her lender rejected her loan application, citing her FICO score, which, at 626 is unchanged from last year, she says. She says her parents are dealing with financial setbacks of their own, and haven't qualified for federal Plus loans in the past.

"Ms. Henry says she will try to get through the fall semester by working 24 hours a week as a nurse's assistant, while also dealing with a full load of classes and clinical assignments. But she worries she won't be able to maintain her B average and handle the job during the spring semester, when she is obliged to complete an unpaid 40-hour-a-week internship. 'I'm scared half to death,' Ms. Henry says."

And that is the way that the world's wealthiest nation treats the most productive investment that a government can make.

W.K.