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Are We Rediscovering Our History? We will Soon Catch Up with Columbus.

It is only a month or so that the name of the *Glass-Steagall* law, which in 1933 got the world moving out of the Great Depression, rated the barest mention in our contemporary press. And now on opening *The Globe and Mail* (18/07, "Encouraging inflation: Heresy or the way out of a rut?" by Boyd Erman), we were rocked on our heels to find: "A small group of influential economic thinkers has a conversational proposal for central bankers: Drop the fight against inflation for a while.

"Encourage prices to rise faster than they have in decades, the argument goes, and the inevitable long recession that comes with it are a greater risk than inflation, because rising prices will prod consumers to spend; and because inflation devalues past debts and will help people who are underwater.

"The idea is anathema for those raised on the anti-inflation orthodoxy of recent decades, or those who endured the rapid price jumps of the 1970s.

"Yet, the proponents of the idea had serious credentials. They include Ken Rogoff, a former research director of the International Monetary Fund and now an economics professor at Harvard; Paul McCulley, a portfolio manager at Pimco, which runs the world's biggest bond mutual fund; and John Makin, an economist at the conservative American Enterprise Institute, not the kind of think-tank that would normally espouse such a radical idea.

"With reports this week showing that consumer prices in both the US and Canada fell in May, the risk of deflation should be a hot topic.

"Instead, many investors dismiss it as a blip, fixating on the chance that the money printed by governments to prop up the economies and to lubricate the financial markets will spark runaway growth and inflation.

"So even with inflation on the radar, government bonds had another rough week as investors bailed out on inflation concerns, while stocks rose on recovery hopes.

"'Any student of history and bubbles is very nervous about deflation getting out of hand,' Mr. Makin said in an interview. 'If it really gets rolling, you really have a hard time turning things around.'

"So why the focus on the risk of inflation?

"'Intuitively people are probably not very well informed about deflation and disinflation because it hasn't been around very much,' Mr. Makin said. 'It's very easy for commentators to get worked up about all this government debt, printing money – the end of the world but with excess capacity where it is, it's more likely that we'll see the inflation rate drifting down.'

"Drifting down it is. North America has been experiencing disinflation, the wonkish word for a period when prices are still rising but ever slower, for months. And now, there is deflation, where overall prices are actually going down.

"After its recent peak of 3.5% in August of 2008, the inflation rate in Canada has steadily dropped and in May read negative for the first time in 15 years at minus 0.3%, a report yesterday showed.

"The inflation rate has been negative in the US for four months now.

"Much of that admittedly has to do with gasoline prices, which have slumped after soaring in the middle of last year, However, with so much slack in both economies, high unemployment, stagnating wages and companies struggling for, it's hard to imagine

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Columbus *from page 1*

prices for other goods going up very quickly any time soon.

"So Mr. Makin and his peers argue that the answer, should sustained deflation become more of a risk, is for central bankers like Canada's Mark Carney and the US Fed' Ben Bernanke to broadcast that they would allow inflation to be much higher than the 2% or so it's averaged over the boom years. How much higher? Mr. Rogoff has suggested 6% for a couple of years, if need be.

"That would stop the cash-hoarding instincts that are holding back recovery in what Mr. McCulley of Pimco recently called a 'liquidity trap.' It would essentially be an ultimatum: spend the money you've got now, because it will be less tomorrow.

"Also, inflation would increase asset values relative to debts incurred in the past, easing the burden on society of the massive borrowings taking place and even potentially arresting the slide in the US housing market.

"The problems with the idea are the flipsides of those advantages – inflation devalues savings and hurts lenders, who are paid back in dollars that aren't worth as much. Bondholders would scream long and loud, as would the inflation hawks who have had the ear of investors for a long time.

"As Mr. McCulley puts it, embracing inflation is just not discussed in 'politically correct circles.'

"But it may not need to be, if the stimulus plans now under way can't get us out of the economic quicksand. The timing would be tricky. If the central banks say too early that they want or will allow more inflation, lenders will push up interest rates to compensate, which is counterproductive.

"'You have to wait, wait, wait until people get very, very frightened about deflation and that runs the risk of actually moving too late,' Mr. Makin said.

"As Mr. Makin said, it's not a good option, but it may very much may end up being what's needed.

"Maybe that's why post-bubble situations don't end very happily."

Now, just to get started, let's identify one source of the great troubles of these active minds struggling to identify the problem haunting them. Why do they assume that what is depressing prices is simply the same force that had so often been driving them down. That raises a neglected problem of logic that none of these distinguished professors of leading universities even suspect, let alone address.

If I put a loaded revolver to my head and press the trigger, I fall dead. But you cannot reverse such logical propositions and assume them still valid. If I fall dead it is not that I have put a loaded revolver to my temple or even found another means of killing myself – it could have been heart-failure or any of countless other causes. When I dealt with that problem in the 1960s, the first thing I did when I found those other causes that made prices rise was to nail down the new factors having nothing to do with the mere reverse of the factor that had been pushing up prices. The name I chose and still use is the "social lien," and tied it essentially to the services provided not by the market but by public services. When my 60-some page manuscript on my discovery was purchased by what was then the leading economic journal of France, the review that appeared in the Cambridge University economic journal congratulated me on that well-chosen terminology.

No one moving from a town of 20,000 to New York City assumes that his living costs will stay the same. How could they possibly do so when humanity itself has been making such a move? The cities of 5 million inhabitants today are almost beyond counting. The population of Greater Mexico City is some 30 million. Need I point out that large cities require special subway or overhead transportation, universities for investment in human capital, schools, hospitals and all the cultural facilities that are cause and purpose of modern cities.

No sooner had I formulated my model than a member of the COMER board, Harvey Wilmeth of the University of Wisconsin, improved my model by pointing out that the social lien is included in the end prices of production not once, but twice: once as the taxes on the private-sector output and again in the cost of public services because of their consumption of the private sector items already taxed. Wilmeth devised a helpful popularization of the social lien idea to make his point.

"Merchants frequently offer some additional product 'free of charge' as a bonus to stimulate sales. For example, a free $100 bicycle with each purchase of a $400 television. How should such a transaction be measured for national output purposes? Did a $400 joint purchase take place, or did the buyer receive a free bicycle worth $100 and a $400 TV?

"Most observers would agree a joint purchase took place at a total price of $400 and that the amount should be appropriately allotted to each of them.

"Now, instead of a free bicycle, think of free government services. Using a joint purchase example again, assume that the government levies taxes that can only be recovered from increased prices of goods sold over what prices would otherwise be. Funds from the taxes that are given away, yet their costs are also included in GDP through the higher prices necessary to recover the tax costs, and a second time for including a cost-based value of 'free' government output."

In the same issue of *ER* I discussed the significance of Wilmeth's parable on the social lien and analyzed the phenomenon mathematically: "If the output of the public sector (P) is subtracted from the GDP to correct the duplication, the average quantity of the GDP will be adjusted by a factor G/G+P. Dividing the numerator by the denominator, this is equivalent to the infinite series: $1 + P/G - (P/G)^2 + (P/G)^3 - (P/G)^4 + \ldots$"

This is a remarkable result achieved with some tuppenny mathematics. The cost of state services must be borne twice by real GDP that in fact is smaller than first appeared because of the double inclusion of the public services.

Returning to Wilmeth's analogy, if you were to ignore the value of the bike you got free with the TV and attributed the entire $400 to the cost of the TV you had previously been able to buy for $300, you would conclude that there had been a 33% inflation. Something of that sort has happened by the government ignoring the effect on price of unpriced public services.

There is, of course, a vested interest in our speculative banking community confounding any price rise with inflation properly defined as an excess of demand over available supply. "Available supply" must be redefined to include proper protection of the environment and investment in human capital such health and education, and countless other public services.

William Krehm

Correcting a Train Wreck by Putting the Shattered Train on the Twisted Rails While a New Bureaucracy Restores the Conditions that Caused the Disaster

That is a long title, but what is involved is an incredibly ongoing process.

The Wall Street Journal (16/07, "Banks Ramp Up Pay Packages to Top Talent" by Kate Kelly and Sara Schaefer Munoz) tells a tale that leads you to rub your eyes and ask whether this is actually happening, or is it a nightmare? "Some big banks that have received government bailouts in the US and Britain are offering handsome pay packages to lure stars and reverse last year's steep losses."

But would these same stars pursuing the same egregious rewards not reproduce the disasters from which the world economy has collapsed?

"Bank of America Corp. recently hired a top bond salesman with a guaranteed two-year deal valued at about $6 million for the first year, people familiar with the matter say. Citigroup Inc. offered nearly $2 million in an attempt to recruit a top brokerage executive. And Royal Bank of Scotland Group, PLC, Britain's largest recipient of government bailouts, is offering pay packages to lure or retain some people that are at or above the industry's peak pay in 2007, people familiar with the deals say.

"The offers come in the wake of an uproar about lofty pay packages in the financial world. Some strong banks such as Goldman Sachs Group Inc. are ramping up pay amid big profits. But some weaker banks buoyed by governments on both sides of the Atlantic also need to keep pay high enough to remain competitive, while avoiding the wrath of lawmakers.

"'The state is helping these banks stay in business so they are essentially offering this compensation using state money,' says Chicago-based compensation consultant Mark M. Reilly. 'This has really been a surprise for other banks, who thought compensation was going to drop.'

"Bank of America's offer shows how some banks that have received US government help under the Troubled Asset Relief Program, or TARP, are likely to navigate new pay structures. Under rules adopted this year, the Treasury Department has oversight of how TARP recipients, including BofA and Citigroup, pay their top 100 earners.

"While those firms still have some latitude over base salaries and stock awards, their 25 top-paid employees can't receive bonuses equal to more than one-third of their total pay for a given year, and the bonuses must comprise long-term restricted stock units that tied the individual's pay to the company's performance.

"In a recent hire, Bank of America guaranteed bond salesmen Bryan Weadock a two-year deal that includes a package of stock and cash and cash valued at about $6 million for his first year, according to people familiar with the matter. The 46-year-old Mr. Weadock, who started his new job this month, didn't respond to requests for comment.

"Government restrictions wouldn't affect the pay of a new hire like Mr. Weadock in his first year, officials say. That is because employees must have been a member of the prior year's top-100 list to be subject to the bonus curbs. But if a $6 million payout places Mr. Weadock among Bank of America's top earners this year, his pay could be affected in 2010. As part of the deal he struck with B of A, his pay will be determined partly by stock units that vest with time.

"Mr. Weadock had spent 17 years at J.P. Morgan Chase & Co., but in recent years had been paid significantly less than $6 million, a person familiar with the matter says, and because the bank has a policy of not matching outside offers, they wouldn't compete with Bank of America.

"Bank of America is committed to complying with all of the government's compensation regulations and looks forward to working closely with Kenneth Feinberg, the Treasury's new pay czar, as BofA's spokeswoman says. 'We will continue to respond to competitive pressures in the market and attract and retain top talent.'

"Bank of America has had a longstanding policy of 'pay for performance,' which is exactly what the public expects and the rest of the industry is adopting, she added.

"Big TARP recipients could face a perception problem, however. In February, Citigroup offered nearly $2 million to recruit Kevin Harrison, 49, for a senior position in its 'prime brokerage' division, which handles lending and trading to hedge funds and other big trading firms, from Deutsche Bank AG, people familiar with the matter say.

"Mr. Harrison told Citigroup executives he was planning to come, these people say, only to reverse the decision in March amid uncertainty about Citigroup's future and the pay they had offered him. He didn't return a call seeking comment. A Deutsche Bank spokeswoman had no comment."

Citigroup Seeking Pay Formula to All But the Sales Talent Who Brought On Our Crisis

"'Retaining and attracting the best talent is very important to the success of Citi and all its stakeholders,' a Citigroup spokeswoman says. 'Citi continues to examine ways to ensure its employee-compensation practices are competitive in this very challenging market environment.'

"Citigroup also faced pay issues at Phibro LLC, its lucrative energy-trading division. Led by Andrew Hall, who received an estimated $100 million in compensation last year, Phibro had generated hundreds of millions of dollars in profit for Citigroup over the years.

"But this spring, after the new pay curbs were unveiled. Citigroup has weighed spinning the unit off as a separate entity, among other options Hall and others on his team threatened to leave if their pay was cut by the rules, people familiar with the matter said. Mr. Hall declined to comment.

"Royal Bank of Scotland is under close watch of UK Financial Investments Ltd., the government body that manages the British government's 70% stake in the bank. Earlier this year, RBS agreed to overhaul its pay, including banning 2008 cash bonuses, shrinking the 2009 bonus pool by 90%, and freezing pay for directors and executives.

"The bank also introduced deferred awards and claw backs to the awards subject to future losses.

"The agreement says RBS will 'follow the same approach for 2009.' But the past is likely to be amended during this year's second half to give RBS more pay flexibility, a person close to the matter says.

"Within RBS's new pay structure, the banks has offered handsome salaries to some recent hires, including Antonio Polverino, as top Merrill bond salesman, and Lehman Brothers' Kaushik Amin, who was hired to be chief executive of RBC's commodities-trading joint venture with Sempra Energy. And to retain some existing fixed-income salespeople, the bank has elevated packages to higher than 2007 levels by raising commissions, according to a person close to the matter. Messers Polverino and Amin couldn't be reached for comment.

"RBS declined to comment specifically on how many people it has hired this year or on the size of the pay packages. It says most of the hires replacing departing staff. The bank has offered just 'a handful' of guarantees, says RBS spokesman Steven Blaney.

"'We will continue to act commercially, which includes paying our people in line with global peers; anything else impacts our ability to attract and retain the staff we need to support our clients and create value for shareholders,' Mr. Blaney says."

However, what comes out of this tight-lipped dribble of information is that "delivering more of the same," no matter how increased the efficiency may be will bring society finally crashing to the bottom of the canyon.

But enough of focusing our criticism on other countries. How are we faring at home? Let us consult *The Financial Post* (17/07, "PM 'off base' to slam report, economist says" by Paul Viera): "Ottawa – A veteran Bay Street economic and fiscal forecaster has come to the defense of Parliament's budget watchdog, arguing yesterday that the Prime Minister and Defense Minister are 'off base' in labelling Kevin Page's report as too pessimistic.

"Dale Orr, head of his own Toronto-based economic consultancy and a long-time federal finance watcher, said unless the Conservative government changes its current plan, which would entail raising taxes and cutting program spending, Canadians had better brace for a decade of deficits.

"'If this is their preferred option, then they must ensure they have the Canadian public, as well as their political opposition, on board to accept deficits for the next decade,' Mr. Orr said in a paper on the federal budget balance.

"Last week, Mr. Page released a report indicating Ottawa was at risk of running a structural deficit and could not get back to surplus by 2014, as pledged, unless it raises taxes or cuts expenses."

The important word in that sentence is "structural" deficit that has been missing in the millions of words lavished on our economic crisis. A structural crisis is when the incomes on which income tax can be collected shrinks and when the sales on which sales tax is levied do not take place. Nothing complicated about that. And more people to at least make a gesture of helping to support when they are out of jobs, because employers are going broke. When the economic structures are moving in the opposite direction, balancing a budget happens almost on its own and throws off a surplus.

Wisely? What is foolish and what is wise in the political game? The answer is another question: "For whom?"

And there we come upon another great divide in the road. There are those who work at producing goods and services, and those who own or borrow the capital which tends to come in ever larger masses to support the scale and complexity of modern production. It must be made available in adequate quantity, when needed and on adequate terms to make it possible for the entrepreneurs, and the labor force to exercise their organizational and productive skills. All this then involved a degree of balance that makes for a functioning economy. If any of those overreach themselves in these crucial roles, society risks becoming nonfunctional. A structural deficit ensues.

On Structural Deficits

Historically elaborate measures were taken to prevent this from happening. Trade around the Mediterranean developed early, and left traces in place names like Barcelona in Spain, which is based on the Semitic word for iron, Barzel. Phoenicians not only cut down the forests in Palestine but contracted the building of temples with it overseas, but on the way back on such deliveries they obviously picked up iron or iron ore possibly from Basque country on the other side of Spain. The Phoenicians in fact developed a bad reputation for not confining themselves to picking up available materials from almost anywhere along the Mediterranean, but cutting out all middlemen and getting to the actual producers to reap a bigger profit.

With the emergence and rapid spread of Islam the morality of trade came in for much attention. Like the Hebrews the Muslims took a rather jaundiced view of interest charged, but ruled more sharply focused on owing interest when the lender did not share in the risk of a transaction. From there the development of double entry or accrual accountancy was a relatively small step. This required that every transaction be entered in an entrepreneur's ledgers twice. Once noting the money or credit the partners put into the investment, and this was "amortized" – i.e., paid off according a forecast schedule ("to the extermination" in Latin), and on the other side the physical assets were "depreciated" (from Latin *pretium* for "price") its current worth. This allowed fair settlements of the distribution of the proceeds of joint enterprises by the moral standards of Islam. These accountancy rules were brought to central and Western Europe by the Knights Templar, and made possible not only the glories of the Venetian Republic, but both the costly long maritime trips that led to the discovery of the Americas and the way around the Cape of Good Hope to Southern Asia and China and Japan. Less profitable to the bankers many of whom went broke, they helped finance the wars that led to the organization of the small feudal fiefs in Europe into modern nations.

As European banks progressed and took over entire economies, there was less and less readiness to share risk without good security from their customers. And governments, too, though insisting on some resemblance of double entry booking being observed by their clients, were reluctant to share their risk with them except against good security.

The matter came to play a key role in the adoption of double-entry accountancy by governments after the disastrous take-over of the Savings and Loans (mortgage trusts) in the US in 1996 and in Canada to a lesser extent in 2002. The banks, being allowed to ignore the *Glass-Steagall* law even before it was repealed suffered bankruptcies and had to be bailed out at great cost to their governments. This was done in two stages. In 1988 they were allowed on meeting certain capital – not liquidity – tests were able to load up with the debt of developed countries with no down-payment. And three years later the Bank for International Settlements that had organized this earlier bailout, pronounced that a zero amount of inflation – meaning any higher prices – must be suppressed with higher interest rates. What BIS and all the central bankers it had gathered around its knees overlooked: if you raise the benchmark interest rate substantially bonds issued when rates were much lower shed their value.

That is what happened in 1992 and almost brought down the world banking system. The US Treasury, the IMF put up $25 billion each and Canada a single billion dollars for what at that point was the largest fund for such a purpose ever raised. It proved not needed to be used. But it shook President Clinton so deeply, that he lost no time in bringing accrual accountancy into the US government books where *physical* investments were concerned. Up to then the credit or cash that paid for them had been amortized over roughly the expected term of the investment's useful life, but their market value was written off *in a single year.* Thus all that was left of that value in year two was a token dollar. That had a double effect on the government's apparent finances and hence on the economy. (1) It produced a huge net debt that simply was not there, but served to drive up interest rates, and (2) it produced some sensational privatizations for the well-connected. Carried back to the year 1959 President Clinton's reform brought to light some 1.5 trillion dollars as appeared in the Department of Commerce figures for the first time in January 1996 – under the misleading heading of "savings" which they were not since "savings" implies cash or very short term securities of prime quality and these assets consisted in part of highways, bridges, century-old buildings. But once governments are launched on deception it is like walking on rainbows. Only rarely will they come clean about what they are up to.

All this has a tremendous relevance to the world's current quandary. For this I must take you back to the end of the Second World War when Washington sent hundreds upon hundreds of economists to Japan and Germany to study the destruction to predict how long it would be before those two great trading powers could resume such roles again. Some sixteen years later, one of these Theodore Schultz of the University of Chicago, published his conclusion that it was amazing how wrong they had been in their predictions.

This he concluded was due to their having concentrated on the *physical* destruction, and given little attention to the fact that the highly educated, disciplined, and talented work force had come through the fighting almost intact. He went further. From this he concluded that investment in *human capital* is the most productive investment governments can make. For a very few years Schultz was celebrated and even decorated. And then utterly forgotten. I would love to be corrected, but COMER seems to be the only organization that still remembers even his name. Yet his ranking of government investment in human capital is undoubtedly the most important lesson to have come out of the Second World War.

Today all this has an immense importance in enabling the world to get out of the perilous blind alley into which those in the saddle have worked themselves today. Better than anyone else, that I am aware of, this has been explored by a French economist with whom I was closely connected – François Perroux. He held that in every society the "dominant revenue" is the revenue of the class or sub-class whose revenue is taken as the index of the well-being of society as a whole. And of course, the alleged laws of economic theory are reworked to make possible this arrangement. Thus during and after the Napoleonic Wars in Britain it was the rents of the large landowners that had that role and tariffs on foodstuffs were kept high to keep the ground rents high. But by the mid 1830s the role as "dominant revenue" had passed to the pioneer industrialists, who favored free trade for at least two reasons. Firstly, it would allow the entry of cheap foodstuffs and then make it possible to reduce the already very low subsistence wages they paid their workers. It would spread the evangel of free trade to foreign nations who had still not introduced steam power in their factories.

Enter the "Dominant Revenue"

By the mid-1830s the Britain reduced its tariffs, and the "dominant revenue" became that of the industrialists and economists like David Ricardo, switched to one or another version of the labor theory of value to support the dominate revenue of the day – industrial profits. That was all right so long as the British workers were largely unable to read or write so they could draw no seditious conclusions from any labor theory of value.

But by mid-century the workers were learning to read, and in 1848 barricades were being thrown up in most of the capitals of Europe. Still more menacing is the detail that the defeated socialist and anarchist leaders were flocking into Britain as refugees, including Karl Marx and Friedrich Engels themselves. And before you knew it, Karl Marx's tragic, gifted daughter was amongst the many of these organizing open – air meetings in Hyde Park, almost within earshot of Buckingham Palace. It was time for a drastic change of the "dominant revenue." It consisted of a restructuring of economic theory to explain the source and measure of value in any commodity not by the average labor that entered its production, but by the degree of enjoyment it created for its consumer. So urgent was the switch in the "dominant revenue" that it occurred quite independently in three European capitals quite independently within a few years of one another.

President F.D. Roosevelt was successful in bringing in the *Glass-Steagall Act* barring the banks from taking over other non-banking financial pillars – at the time stock brokerages, insurance and mortgage corporations – because the "dominant revenue" of the day lay broken. Even leading industrialists such as Henry Ford and Thomas Edison were critical of banks. The only banker involved in that basic pioneer reform was not from Wall Street, but from Salt Lake City. Had it not been for that, Roosevelt might have given us an advance version of President Obama.

A misplaced sprinkling of differential calculus, was grossly mistaken as guaranteeing the scientific power of the new value creed. In actual fact, the empirical content of any mathematics is zero, though its powers of analysis are unbounded. Uncounted are the number of mathematicians that have appraised the role of calculus in marginal value theory most unflatteringly. Without that the current mega-swindles of subprime securities could not have happened. For not everything is insurable. A good many bundled securities are not only "risky" but wrong. For example if I take out insurance on 2 + 2 = 5, it is not just risky, it is wrong. If insured it is likely to cause both the insurer and the insured going broke. The trick is for the perpetrators of such scams to market them quickly enough by "bankers exit," also known as unloading them to a "greater fool."

It is also important to consider what such improvisations do to the very definition of "legal tender." That require that anyone making a legitimate offer to repay a debt according to contract in legal tender, and having been turned down, is quit of the debt.

Returning to our present problem. We have only our history, good and bad, to learn from. Erase that from our minds, university curricula and books, and we are lost. In 1992 to 1996 President Clinton brought in accrual accountancy in the accountancy covering government investments in physical investments.

Working the figures back to 1959 his accountants retrieved some 1.5 trillion US dollars in investments completely written off in a single year. If we allowed just the value on the exchange lost through higher interest rates due to the exaggerated, compounded interest payments during that period it would amount most conservatively to some 3.5 trillion US dollars. Taking 10% of that as the usual relationship of such major Canadian statistics and their relationship to their US equivalent, and we most conservatively come up to a grossly understated $350 billion US dollars.

That is prepaid investment in unrecognized investment of our government in human capital, that the US government experience appraised by Theodore Schultz had rated as the most productive investment governments can make.

There remains only to be added that investments in human capital by government have very often the characteristics of investments themselves. The children of educated parents are easier to educate, tend to be healthier, and better adjusted. Britain is still receiving dividends, as it were, from whatever investment Stratford-on-Avon spent teaching a Billy Shakespeare the glories of the English tongue, or what Lincolnshire laid out instructing Izzy Newton on algebra.

The debates precipitated by President Obama's banker-managed human investments treat them only as spending, when in fact they are investments, prepaid. As such they should have no trouble being financed by our central bank, or in the US. by the Fed. Though the US Fed is owned by private banks, a good portion of its revenue does revert to Washington for the surrender of the ancestral monopoly of money creation.

It is time that we blew the whistle that this nonsense must stop!

William Krehm

Brazil Following the Obama Lead and Puts Our Domestic Politicians to Shame

Years ago little Norway, having struck rich oilfields offshore had the gumption to pursue worthy goals. If they simply treated these offshore oil revenues as income, they would drive up the value of the Norwegian currency to the point where their economy would wither. Moreover, sooner or later the rich off-sure oil fields will be exhausted, and there would be little left from them but a depressed economy. So it chose to invest that economy in human capital. Obviously they had been looking over the shoulder of Washington's great experiment at the end of World War II.

Washington had sent hundreds upon hundreds of economists to Japan and Germany to study the war damage, and from it to predict how long it would be before those two defeated powers could resume being the formidable traders they once had been. A decade and a half later one of these, Theodore Schultz of the University of Chicago published his judgement that he and his colleagues could not have been worse prophets. It was, he explained, that they had concentrated on the physical destruction of the war, but they had overlooked that their unusually educated, gifted and disciplined work force had come through the conflict almost intact. But he didn't stop there. From that he concluded that investment in human capital is the most profitable investment a government can make.

For a few years Schultz was celebrated and even decorated. And then he and his conclusion were buried – probably the most important lesson to come out of World War II. But Norway made great use of it.

And now we learn (*Financial Post,* 07/22, "Brazil mulls social fund from oil sales" from Bloomberg News) that Brazil – a country very deficient in human capital under a discreetly leftist government – has borrowed the Norwegian model conceived from a costly experiment the results of which Washington – even under Obama – by nary a twitch of a facial muscle even betrays to exist.

Let us quote: "Brazil may create a fund to pay for education and other social programs using cash from sales of oil from recently discovered fields off the nation's coast, Cabinet chief Dilma Rousseff said.

"'New regulations to govern the exploration of the so-called pre-salt field may include 'a new social fund to ensure Brazil's population benefits from the nation's oil wealth,' Ms. Rousseff told reporters yesterday in Washington, DC. The fund would be used to pay for investments in education, science and technology and to fight poverty. She added: 'When you have this amount of oil, you need to avoid the so-called oil curse – a lot of oil and a lot of poverty,' Ms. Rousseff said.

"President Luis Inacio da Silva has given the commission in charge of drafting the regulations until the end of August to send him an initial proposal,' Ms. Rousseff said.

"Brazil's pre-salt area runs 800 kilometers along the coast and has oil deposits beneath a layer of salt resting as much as 3,000 meters beneath the ocean and another 3,000 to 5,000 meters below the seabed.

"It's unlikely the regulations will dampen interest among foreign investors and oil companies in the pre-salt field, Ms. Rousseff said."

W.K.

Introducing Our Suddenly Closer Neighbor — China

In *The Wall Street Journal* (12/07, "China's Ethnic Fault Lines") Dru C. Gladney, president of the Pacific Basin Institute at Pomona College) introduces us to the vast ethnic, linguistic and cultural diversity of what is become our next-door neighbor, China.

"The myth of a monolithic China was shattered this past week. Running barely beneath the surface of what the government has sought to portray as a 'harmonious' society, the fracture created by the Urumqi and Lhasa riots threatened to shake the country.

"Foreigners and the Chinese themselves typically picture China's population as a vast Han majority with a sprinkling of exotic minorities living along the countries' border. This understates China's tremendous cultural, geographic, and linguistic diversity – in particular the important cultural differences within the Han population. Across the country, China is experiencing a resurgence of local ethnicity and culture, most notably among southerners such as Cantonese and Hakka, who are now classified as Han.

"Cultural and linguistic cleavages could worsen in a China weakened by internal strife, a struggle over future political concessions. The initial brawl between workers in a Guangdong toy factory, which left at least two Uighur dead on June 25, prompted the mass unrest in Xinjang on July 5 that ended with 156 dead, thousands injured and 1,500 arrested, with ongoing violence spreading throughout the region.

"China is also concerned about the 'Kosovo effect,' accusing its Muslim and other ethnic minorities of seeking outside international (read Western) support for separatist goals. But ethnic problems in President Hu Jin-tao's China go far deeper than the 'official' minorities. Sichuanese, Cantonese, Shanghainese, and Hunanese are avidly advocating increased cultural nationalism and resistance to Beijing central control. Ethnic strife did not dismantle the former Soviet Union, but it did come apart along boundaries defined in large part by ethnic and national differences.

"The unprecedented early departure of President Hu from the G-8 meetings in Italy to attend to the ethnic problems in Xinjiang is an indication of the seriousness with which China regards this issue. The National Day celebrations scheduled for October 2009 week to highlight 60 years of the 'harmonious' leadership of the Communist Part in China, and like the 2008 Olympics, its enormous success. The rioting threatens to derail these celebrations.

"Officially, China is made up of 56 nationalities; one major nationality, the Han, and 55 minority groups. The 2000 census revealed a total official minority population of nearly 104 million, or approximately 9% of the population. The peoples identified as Han comprise 91% of the population, from Beijing in the north to Canton in the south, and include the Hakka, Fujianese, Cantonese, and others. These Han are thought to be united by a common history, culture and written language; differences in language, dress, diet and customs are regarded as minor. An active state-sponsored program assists the official minority cultures and promotes their economic development (with mixed results)."

The Toppler of the Last Dynasty, Sun Yat Sen, Educated in Hawaii

"Sun Yat Sen, leader of the republican movement that toppled the last imperial dynasty of China (the Qing) in 1911, promoted the idea that there were 'Five People of China' – the majority Han being one and the others being the Manchus, Mongolian, Tibetan, and Hui (a term that included all Muslims in China, now divided into Uighurs, Kazakhs, Hui, etc.). Sun was a Cantonese, educated in Hawaii, who wanted both to unite the Han and to mobilize them and all other non-Manchu groups, Tibetans and Muslims) into a modern, multi-ethnic national movement against the Manchu Qing state and foreign imperialists. This expanded policy with the recognition of 55 minority nationalities, also helped the Communists' long-term goal of forging a United Chinese nation.

"Cultural diversity within the Han has not been officially recognized because of a deep well-founded) fear of the country breaking up into feuding kingdoms; as happened in the 1910s and 1920s. China has been historically divided along north-south lines into Five Kingdoms, warring states or local satrapies, as often as it has been divided. China, as it currently exists, including large pieces of territory occupied by Mongols, Turkic peoples, Tibetans, etc., is about three times as large as it was under the last Chinese dynasty, the Ming which fell in 1644. A strong centralizing government (whether of foreign or internal origin) has often tried to impose ritualistic, linguistic, economic and political uniformity throughout its borders.

"The supposedly homogeneous Han speak eight mutually unintelligible languages (Mandarin, Wu, Yue, Xiang, Hakka, Gan, Southern Min, and Northern Min). Even these subgroups show marked linguistic and cultural diversity. In the Yue language family, for example, Cantonese speakers are barely intelligible to Taishan speakers, and the Southern Min dialects of Quanzhon, Changzhou and Xiamen find it equally difficult to communicate. The Chinese linguist Y.R. Chao has shown that the mutual unintelligibility of, say, Cantonese and Mandarin is as great as that of Dutch and English or French and Italian. Mandarin was imposed on the nation as the national language early in the 20th century and has become the lingua franca, but like Swahili in Africa, it is rarely used in everyday life across much of China.

"The country's policy towards minorities involves official recognition, limited autonomy, and unofficial efforts at control. They are concentrated in resource-rich areas spanning nearly 60% of the country's landmass and exceed 90% of the population in counties and villages of Xinjiang, Tibet, Inner Mongolia and Yunnan. Xinjiang occupies one sixth of China's landmass, with Tibet the second-largest province.

"Surprisingly, it has now become popular, especially in Beijing, for people to 'come out' as Manchus or other ethnic groups. While the Han population grew 10% from 1982 to 1990, the minority population grew 35% overall – from 67 million to 91 million. The Manchus, long thought to have been assimilated into the Han majority, added three autonomous districts and increased their population by 128% from 4.3 million to 9.8 million. The population of the Gelao people in Guizhou shot up an incredible 714% in just eight years. These rates reflect more than a high birth-rate; they indicate 'category-shifting' as people redefine their nationality from Han to minority or from one minority to another. In inter-ethnic marriages. parents can decide the nationality of their children, and the children themselves can choose their nationality at age 18.

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"Why is it still popular to be 'officially ethnic' in today's China? This is an interesting question given the riots in Xinjiang recently and in Tibet last year, not to mention the generally negative reporting in the Western press about minority discrimination in China.

"By the mid-1980s it had become clear that those groups identified as official minorities were beginning to receive real benefits from the implementation of several affirmative action programs. The most significant privileges included permission to have more children (except in urban areas, minorities are not bound by the one-child policy), pay fewer taxes, obtain better (albeit in Mandarin Chinese) education for their children, speak and learn their native languages, worship and practice their religion such as shamanism that are still banned among the Han) and express their cultural differences through the arts and popular culture.

"Indeed, one might even say it has become popular to be 'ethnic' in today's China. Mongolian hot pot, Muslim noodle and Korean barbecue restaurants proliferate in every city, artistic motives adorn Chinese private homes. In Beijing, one of the resource-rich areas, one of the most popular restaurants is the Tibetan chain of Makye-ame. There, the nouveaux-riches of Beijing eat exotic food such as Yak Kabobs served by beautiful waitresses in Tibetan clothing during Tibetan music and dance performances.

"With the dramatic explosion in South China, southerners and others have begun to assert cultural and political differences. Whereas comedians used to make fun of southern ways and accents, southerners (especially Shanghainese) now scorn northerners for their lack of sophistication and business acumen.

"As any Mandarin-speaking Beijing resident will tell you, bargaining for vegetables or cellular telephones in Guangzhou is becoming more difficult due to the growing prices in the local languages. Non-native speakers always pay a higher price. Rising self-awareness among Cantonese is paralleled by the reassertion of identity among the Hakka, the southern Fujianese Min, the Swatow and other peoples empowered by economic success and embittered by age-old restraints from the north.

"Interestingly, most of these southern groups traditionally regarded themselves not as Han but as Tang, descendants of the great Tang dynasty (618-907 AD) and its southern bases. Most Chinatowns in North America, Europe and Southeast Asia are inhabited by descendants of Chinese immigrants from the mainly Tang areas of Southern China.

"The next decade may see the resurgence of Tang nationalism in southern China in opposition to northern Han nationalism, especially as economic wealth in the south eclipses that of the north. Some have postulated that the heavy coverage by the state-sponsored media of the riots in Xinjiang, as opposed to the news blackout in Tibet was a deliberate effort to bring the majority population together during a period of economic and social instability.

"China's very economic vitality has the potential to fuel ethnic and linguistic division, rather than further integrating the country. As southern and coastal areas get richer, much of central, northern and northwestern China hasn't kept up, increasing competition and contributing to age-old resentments across ethnic, linguistic and cultural lines. Uneven distribution of wealth has fueled deep resentment in the poorer, often ethnic regions of China."

Is China Becoming De-centred?

"The result of all these changes is that China is becoming increasingly de-centered. This is a fearsome prospect for those holding the reins in Beijing and perhaps was a factor in the decision to crack down on the June 1989 demonstrations in Tiananmen Square, to keep a tight rein on the Olympics and respond swiftly and harshly to riots in Tibet and Xinjiang. Last year the government admitted to more than 100,000 'mass incidents' of civil unrest.

"A China weakened by internal strife, inflation, uneven economic growth or the struggle for political succession could become further divided by cultural and linguistic lines. China's threats will most likely come from civil unrest from within the so-called Han majority. We should recall that it was a southerner, born and educated abroad, who led the revolution that ended China's last dynasty. When the empire fell, competing warlords – often supported by foreign powers – fought for turf."

The significant difference today is that the rest of the world is not butting into China's civil wars for a cut of the cake, but to bring back bread to its own tables. Everything contributing to Chinese unrest adds to the economic troubles of every other country on this planet.

W.K.

The Plight of Europe As It Scoops for a Bottom to Its Economic Crisis

Increasingly Asia is the continent of world-wide hopes for economic recovery – not only China but lesser lands like South Korea Singapore, to say nothing of the new military orders that President Obama has made secure in Afghanistan and Iraq. Europe, however, is increasingly the spoilsport, producing economic reports that read like nightmares.

The Wall Street Journal (25/07) brings us two reports that could be sung like dirges for dead hopes. "Data Jolt Hopes for European Recovery" by Marcus Walker in Berlin and Alistair MacDonald in London: "The fortunes of two of Europe's biggest economies are shifting. The UK gross domestic product fell by 0.8% in the second quarter from the first, and dropped 5.6% year-over-year, the largest annual decline since quarterly records began in 1955. The data punctured recent optimism that the UK was rebounding from its worst recession of the postwar era.

"Meanwhile the closely watched Ifo and purchasing managers index surveys in Germany showed that companies' activity is starting to pick up, after collapsing since autumn. Global demand, especially from Asian countries with large government stimulus plans, is benefitting export-dependent Germany more than other European countries, analysts say.

"The UK's GDP number is a shock, and a reality check to people who thought the UK's recession might even have ended.

"Briton John Lambert, who owns a car dealership and a construction business, wasn't surprised by the GDP news. 'People keep talking about the green shoots of recovery, but this is going to be a long haul,' he said.

"Over the past two years Mr. Lambert made the first layoffs of his 30-year career, letting half his eight-strong car-sales team go. To compensate, he is putting in longer hours, while waiting – along with businesses across the UK – for lending and spending to pick up. Mr. Lambert's predicament differs from that of German firm Karl Mayer GmbH, a family-owned maker of machines for the textiles industry, which is ramping up production after having little to do all winter and spring.

"The company, based near Frankfurt, won 68 new machinery orders from China in the past month, reflecting an increase in Chinese business investment and consumer investment and consumer spending after Beijing's sweeping efforts to stimulate demand.

"Karl Mayer recently laid off 350 workers – a quarter of his staff in Germany – after turn-over fell by two-thirds early this year. 'Some of the workers were questioning why he just made these layoffs,' says staff representative Manfred Hohm. 'Now we're working overtime again.'

"Germany's Ifo business climate-index rose to 85.9 in July, the fourth consecutive rise. Crucially, firms current activity is up as well as expectations for the months ahead, especially at export-dependent manufacturing firms, the Munich-based Ifo economics institute said.

"The PMI for Germany jumped to 48.9 in July, up from 44 in June, hitting the highest level before the collapse of Lehman Brothers in the fall. Other recent German data including exports and new orders in industry show that Germany's economy, the world's fourth largest, is stabilizing quickly after recording a 3.8% drop in GDP in the first quarter from the fourth of last year.

"Economists say they expect Germany's second-quarter GDP data, due for release on August 13, to show only a slight contraction, with growth returning as soon as the third quarter.

"Most of Germany's neighbors in Europe are on a slower path to recovery. The PMY survey for the 16-nation currency zone – which includes Germany but not the UK – rose more modestly to 46.8 in July from 44.6 in June. France's services sector and consumer confidence have taken hits recently, surveys show.

"Eastern Europe continues to be a concern, with the European Bank of Reconstruction and Development warning Friday that those economies face a rise in non-performing loans and corporate defaults severe enough to destabilize their shaky banking systems.

"The UK and Germany are both expected to return to growth in the second half of this year. But both countries' recoveries – and their prospects in the medium term – are fragile, economists say.

"The UK is still thought to be better positioned to recover than most of the euro zone. The pound is down almost 10% against the euro and 17% against the dollar since July 2008, which should help exporters.

"Businesses in both the UK and Germany complain of banks' reluctance to lend, but fears of a credit crunch are higher in Germany because the UK government has done more to help banks overcome losses in US mortgage-related and other toxic securities.

"The UK's customers are saddled with more debt than many other European countries or the US, and unwinding that debt will take demand out of the economy.

"Germany's fiscal-stimulus measures, equivalent to 3.5% of GDP over two years, are much larger than the UK's, which run only 1.5% of GDP, according to the International Monetary Fund."

Spain Despairs Amid Vanishing Jobs

"Monteprincipe, Spain – Luis Sanchez, 41 years old can't sell his home in a gated community with swimming pools nestled among pine trees that he bought three years ago, at the peak of a long boom that followed Spain's adoption of the euro in 1999.

"Having ridden the boom to wealth in jobs ranging from stock-broker and financial director, Mr. Sanchez now finds himself jobless with an unmanageable mortgage. He isn't planning a vacation this year, has negotiated lower fees at his children's schools, and is avoiding restaurants.

"Mr. Sanchez's predicament is echoed across Spain, as anxiety grows at the end of a boom that hinged on speculative housing investment and cheap credit. The low morale that comes from high debt and joblessness is a reason Spain could take longer than other countries to pull out of recession.

"Government data out Friday showed that more than one million households in Spain have no working members. The country's unemployment rate more than doubled on the year to 17.92% in the second quarter, by far the highest rate among the 30 nations in the Organization for Economic Cooperation and Development, following Spain's labor-intensive construction industry. In comparison, the US had a 9.4% unemployment rate in May, according to the most recent OECD data.

"Other large European countries have yet to feel the degree of pain Spain is suffering from the global economic downturn.

"Spain's downturn has room to rise even further. As builders struggle to unload more than one million unsold homes, they will continue to cut jobs. Economists say spending will be damped for years.

"As a result. Spanish GDP will contract about 3.2% this year and 1% next year, the European Commission forecasts. It projects that all other European countries will post at least one quarter of growth in 2010, but Spain won't. 'Spain will be one of the last countries to exit recession,' says Ben May of Capital Economics in London. 'When it does, it's very optimistic to expect it to return to the growth it had before.'

"Spain's fall to earth removes an important engine of European growth. From 1999 to 2007, Spanish GDP grew at 3.7% a year, 1.5% points over the average of the countries using the euro. Spain also created more than one-third of all euro-zone jobs and absorbed four million immigrants during the period.

"The government of Prime Minister Jose Luis Rodriguez Zapatero has introduced an €8 billion ($11.37 billion) local infrastructure plan designed to create temporary jobs and extend unemployment benefits. But the effort has pushed Spain's accounts deep into the red.

"Critics say Mr. Zapatero has shied away from structural reforms and want labor-market deregulation to make it easier to lay off workers. Business leaders say this would make it easier for them to hire some of the millions losing their jobs. The crash comes after three decades of spectacular success, when the country climbed out of poverty of the years of Francisco Franco's dictatorship.

"Mr. Sanchez's father, Antonio, grew up in Morocco. In 1941, his family fled Spain's turmoil and food shortages after the civil war brought Franco to power. But after Franco's death in 1975, Spain embraced democracy and joined the European Union. 'The gap with the rest of Europe was rapidly closing,' says the older Mr. Sanchez.

"In 1999, Spain adopted the euro currency, ushering in a period of low interest rates that helped fuel the biggest growth spurt in the country's modern history. Income per capita surpassed that of Italy, and Mr. Zapatero boasted it would soon surpass that of France and Germany. Households and companies borrowed freely and invested in real estate. Luis Sanchez seized on modern Spain's opportunities, taking a law degree, studying in Seattle for a year, and then becoming a stockbroker.

"Mr. Sanchez bought his home – a white, Andalusian-style villa with a pool, a garden and flower-lined walkways – in 2006. Now he has a large mortgage and no job. He says he is unlikely to afford a house like that again.

"He does not know yet where his family will end up, but he says he is prepared to move out of Spain if necessary. 'Living standards in Spain had reached European levels, but the gains were fictitious,' he said."

W.K.

Extra! Extra! If You Change Just the Colour of the Shoe-laces of the System You Get the Same Results!

The Wall Street Journal (13/07, "Pick-a-Pay Loans: Worse Than Subprime" by Marshall Eckblad) brings us tidings from two of the United States amongst those particularly favoured by government loans and early release from them. But Washington coming out of the experience with little or nothing learned and back at their old games. For the third straight month, option adjustable-rate mortgages are generating proportionally more delinquencies and foreclosures than subprime mortgages, the scourge of the US.

"Option ARMs were typically issued to creditworthy home-owners and allow borrowers to make a range of monthly payments. The payment options include a partial-interest payment that adds the unpaid interest to the loan's balance. On many such loans, balances have risen while values of the underlying properties have plummeted amid the housing crisis.

"As of April, 36.9% of Pick-A-Pay loans were at least 60 days past due, while 19% were in foreclosure, according to data from First American Core Logic, a unit of Santa Ana, Calif.-based First American Corp. In contrast 33.9% of subprime loans were delinquent, with 14.5% of those loans in foreclosure, the figures show.

"Payment-option mortgages are heavily concentrated in the worst-hit regions in the housing market, including California and Florida, making borrowers inordinately vulnerable to declining property values. The deepening loan turmoil could mean higher than expected losses for Wells Fargo & Co., J.P. Morgan Chase & Co. and the Federal Deposit Insurance Corp.'s own insurance fund.

"The realization of the issues related to option ARMs is just beginning,' said Chris Marinac, director of research at Atlanta-based FIG Partners.

"Option-ARM loans are a much smaller portion of outstanding mortgages than subprime loans, but they occupy substantial chunks of certain banks' sheets. San Francisco-based Wells Fargo holds a mountain of Pick-A-Pays, having acquired $115 billion of the loans in its purchase of teetering Wachovia Corp., which it agreed to buy late last year.

"Due to complicated accounting rules, Well Fargo assigns the loans a value of $93.2 billions, giving it room to absorb future losses on the loans. The bank, however, won't say whether the loans have risen beyond the firm's original expectations. Wells Fargo declined to comment Friday.

"In a securities filing in May, the company said that borrowers accounting for 51% of its outstanding Pick-A-Pay balances made only the minimum payment as of March 31, Wachovia used the Pick-A-Pay name for its option ARMs."

Pick a new name and a new system of accountancy is born. Bookkeeping becomes a new faith, with the banks pulled from failed gambles by the forelock with no serious check on how bald the saved institution may be.

"J.P. Morgan holds $40.2 billion in option ARMS that the bank acquired when it purchased most of Washington Mutual Inc. last year. The Seattle company's banking operations were seized by operators, and the holding company filed for bankruptcy.

"The New York company said in a filing its has some exposure to an additional $46.5 billion in option-ARMs sitting in complex off-balance-sheet entities. J.P. Morgan declined to comment.

"The FDIC also could face future losses due to rising problems with the loans. The federal agreed to soak up most future losses from about $5 billion in option ARMS once held by Coral Gables, Fla.-based BankUnited FSB, which the FDIC seized in May and sold to private investors."

W.K.

Descent into Metaphysics

Rummaging for a reference for this year's ER*, I chanced across this chapter II of a work published by me 32 years ago, but nonetheless dealing with the roots of the current world economic mess. It addressed it at such depth that I have decided to publish a portion of a chapter, and put out a new edition of the book. Only a half-dozen copies of the original edition are left. Notably, too, it incorporates a sample of the work of the late John Hotson that remains a worthy memorial to him.*

What is disturbing about our economic theory is not that it has been wrong – it is after all a human science. It is rather that being an all too human effort, it has arrogated to itself quite godly attributes. And as a result it has locked itself in its error and thrown away the key. By the empirical principles that it claims to hold dear, its misfired predictions and policy disasters should long ago have led to correctives. The theory persists like the nagging idiocy of a phonograph needle caught in a damaged groove.

A spurious empiricism somehow shuts off our economists' view of reality. Ours is an age in which quantification has come to fill the niches once occupied by the saints. Mention a statistic baptized in printer's ink and your educated citizen glows with the reassuring feeling that he is dealing with solid facts. The manner in which that statistic has been produced and the validity of the concept behind it are rarely questioned. Nevertheless such uncritical worship of "facts" can befuddle our thinking as much as any transcendental mysticism.[1]

Close to the root of all this is the empiricist tradition in the Anglo-Saxon world. And since in economic theory, the English-speaking countries enjoy something like a right of primogeniture, the effects of this have been felt internationally. An immense amount of analysis of great refinement has been carried on by British and American economists; but both the point of departure and the inference from most of this has been that the common good is best served by leaving matters to the unobstructed wisdom of the markets. Over this a benign providence keeps watch under a variety of aliases ("The Invisible Hand," the equilibrium points of Walras's equations, and so forth). For practical purposes this sort of theory has been self-liquidating. Its belief in the self-balancing features of the economy afforded as stylized an exit from the stage of action as any act of hara-kiri did in the Japanese theater. A weird symbiosis set in between a narrowly empirical practice and a pretentious if gelded system of analysis.

In North America the Yankee tinker arch-type contributed to the cleavage between analysis and practice.[2] The legendary example of this was Henry Ford who revolutionized production while taking no pains to hide his contempt for abstract thinking. If by a more circuitous route, the neo-Keynesian models that have flourished in America also arrived at Ford's unforgettable conclusion: "History is bunk." Since economic activity in their paradigm unfolds according to super-historical principles, it could have little relevance to the workaday world which, after all, is history in the making.

Times there were when such idealized empiricism was an asset. These were the eras when the world was pretty much the oyster first of Britain and then of the United States. In such a situation what was needed was less a theory than an appetite. Today that is no longer the case. We use the expression "mixed economy" glibly, but rarely pause to consider that our economy is no longer governed by a single code. Certainly the rarefied model of the private sector is not remotely to be identified with what goes on in our world today. We have full need of our full powers of analysis to understand the new patterns taking shape around us.

The empiricist tradition stands in the way of our doing so. There is an abiding superstition that whatever is not facts and figures is bound to be a waste of time. We find even Joan Robinson, one of the great economists of our time, dismissing all value theories as "metaphysics."[3] Properly understood, metaphysics is, however, precisely what economists stand in need of – a fundamental rethinking of the relationship of our minds to the reality around us.

There is to begin with the superstition that facts are out there indisputable and ready-made; and that all we have to do is lasso them and bring them home as do cowboys with cattle on the range. The philosophers of symbolism have shown, however, that what we consider "facts" are very much the structures that have taken possession of our thinking. It is these that determine what we can and what we cannot perceive. For economists, imprisoned as they are in concepts that have nothing to do with our economic reality, the point is important enough to dwell upon. It is ironic that a discipline that has attempted to ride on the coat-tails of 18th century physics should have paid so little heed to what has been happening in that science in more recent years.

Suzanne Langer has written: "Genuine empiricism is above all a reflection on the validity of sense-knowledge, a speculation on the ways our concepts and beliefs are built on the fleeting and disconnected reports our eyes and ears actually make to the mind. Positivism, the scientists' metaphysic, entertains no such doubts, and raises no epistemological problems; its belief in the veracity of sense is implicit and dogmatic…. It repudiates the basic problems of epistemology, and creates nothing but elbow-room for laboratory work. The very fact that it rejects *problems,* not answers, shows that the growing physical sciences were geared to an entirely different outlook on reality. They had their own so-called 'working notions,' and the strangest of these was the skeptical, but positivistic – became the official metaphysical creed, experiment its avowed method, a vast hoard of 'data' its capital, and correct prediction of future occurrences its proof."[4]

Such was last-century positivism, the philosophy of science of *our* day. But in our century physics has been wracked by the very metaphysical problems that positivism was supposed to have eliminated forever. "The faith of scientists in the power and truth of mathematics is so implicit that their work has become less and less observation, and more and more calculation. The promiscuous collection and tabulation of data have given way to a process of assigning possible meanings, merely supposed real entities, to mathematical terms, working out logical results, and then staging certain crucial experiments to check the hypothesis against the actual empirical results…. With the advance of mathematical techniques in physics, the tangible results have become less and less spectacular; on the other hand, their significance has grown in inverse proportion…. Observation has become almost entirely indirect; and *readings* take the place of genuine witness. The sense-data on which the propositions of modern science rest are, for the most part, little photographic spots and blurs, or inky curved lines on paper…. What is directly observed is only a sign of the 'physical fact'; it requires interpretations to yield scientific propositions…. The problem of observation is all but eclipsed by the problem of *meaning*. And the triumph of empiricism in science is jeopardized by the surprising truth that our *sense-data are primarily symbols*."

Of crucial importance in all this is the distinction between signs and symbols. "The logical relation between a sign and its object is a very simple one: they are associated somehow to form a pair; that is to say, they form a one-to-one correlation. To each sign there corresponds one definite item which is its object, the thing…signified.

"The interpretation of signs is the basis of animal intelligence. Animals presumably do not distinguish between natural signs and artificial and fortuitous signs. They use both to guide their practical activities. We do the same all day long. We answer bells, watch the clock, obey warning signals, follow arrows…. Because a sign may mean so many things, we are very apt to misinterpret it. Wet streets are not a reliable sign of recent rain if the sprinkler wagon has passed by."

The reader will have no difficulty in recognizing here the structural principles that underlie most of the deductions of conventional economic theory – the "trade-offs" of unemployment for greater price stability; inflation due to an excess of money supply; higher prices signifying an excess of demand and so forth.

Symbols are something else again. "Symbols are not proxy for their objects, but are but are *vehicles for the conception of objects*…. In talking about things we have conceptions of them, not the things themselves; and it is

Union of Nova Scotia Municipalities and the Bank of Canada

23/7/09

Ian:

Good letter except for the paragraph which quotes sub-sections (i) and (j) of section 18. These are not the sections for long term, "lifetime of the assets" financing such as mentioned by Graham Towers.

Richard Priestman

23/7/09

To Nova Scotia Mayors and Wardens:

Many of the problems facing municipalities, provinces and the federal government hinge on money. Infrastructure crumbles, taxes rise, debt at all levels of government escalates from interest on interest incurred on old debt and new debt. Interest payments alone keep most municipalities handcuffed and unable to move forward with necessary improvements and maintenance to infrastructure and services.

The Bank of Canada became the property of the citizens of Canada in 1938. The Bank of Canada is permitted to buy debt the instruments of the federal government, of provincial governments and under certain conditions, municipalities. Article 18 of the *Bank of Canada Act* makes these transactions possible. If the Bank of Canada were used to finance infrastructure projects under article 18 municipalities and the province would save hundreds of millions, if not billions of dollars in interest payments that would otherwise go to privately owned financial institutions. This idea is not new. Much of Canada's financing of world war two was done this way, without creating inflation.

Some background information can be found in the minutes of the Standing Committee of Banking and Commerce from 1939. During the committee hearings Graham F. Towers, the first governor of the Bank of Canada, reveals some points of vital importance. One point that he makes is that for domestic purposes currency issued by parliament is as powerful as gold. The key point being for domestic purposes; this admission came on May 3, 1939. Another point made by Mr. Towers is that Canada is on a fiat money system; Canada's money system is backed by the people of Canada and their productivity. Nobel Prize winning economist Theodore Schultz wrote that investment in human capital is the best investment government can make.

Mr. Towers also advises that a municipality should pay back debts during the life time of the asset. "We will pay the debts back during the lifetime of the assets which we have invested the money in" as the course municipalities should take – accrual accounting – keep in mind the year is 1939 and the words are those of the governor of the Bank of Canada and the federal government only recently (2002) started to adhere to this accounting practice. Financing in this way can save the province and municipalities enormous sums in interest payments.

My purpose in writing is to advise Nova Scotia municipal leaders that funding is available through the Bank of Canada and the federal government. The means are available and unused. Political will does not exist as the federal government refuses to exercise it's authority. Municipal leaders have the legal right secure funding at low or no interest with the assistance of the provincial government.

Bank of Canada Act Article 18(i) make loans or advances for periods not exceeding six months to the Government of Canada or the government of a province on taking security in readily marketable securities issues or guaranteed by Canada or any province.

(j) make loans to the Government of Canada or the government of any province, but such loans outstanding at any one time shall not, in the case of the Government of Canada, exceed one-third of the estimated revenue of the Government of Canada for its fiscal year, and shall not, in the case of a provincial government, exceed one-fourth of that government's estimated revenue for its fiscal year, and such loans shall be repaid before the end of the first quarter after the end of the fiscal year of the government that has contracted the loan.

The phrase "but such loans outstanding at any one time shall not" itself indicates that the unfunded loans specified can be rolled over when due.

Funding of this nature is recommended by "a strong majority" of Monetary Policy Council at the C.D. Howe Institute in April of this year (www.cdhowe.org/english/monetary_policy_council/mpc_press-release_apr_16_2009.html).

The time is right for Canadians to exercise their rights on critical financial matters. Financing through commercial banks at high interest rates is not realistic and has failed Canadians across the country. The Bank of Canada is owned by the citizens of Canada – all of its shares are owned by the federal minister of finance since 1938. Imagine a world where you own a bank and do not use it; really, little imagination is required because you live in that world.

I hope that as part of future meetings of the Union of Nova Scotia Municipalities meet that you will consider this very important issue.

I would consider it a privilege to answer any questions you may have regarding the information I have provided in this correspondence.

Ian Biggs

the conceptions of them, not the things that symbols 'mean.'

"Propositional structure has commanded more interest among logicians of the present generation than any other aspect of symbolism. Ever since Bertrand Russell (*A Critical Exposition of the Philosophy of Leibniz,* 1900, p. 12) pointed out that the Aristotelian metaphysics of substance and attribute is a counterpart of the Aristotelian logic and predicate – that the common-sense view pf things and properties, agents and patient, object and action, etc., is a faithful counterpart of the common-sense logic embodied in our parts of speech – the forms of experience, proposition and facts, have been drawn together closer and closer…. A proposition is a picture of a structure – the structure of a state of affairs."[5]

We shall be misled if we assume that we are somehow dealing with absolutely valid "facts" rather than certain aspects of reality perceived through structures of language and theory. Ernst Cassirer has shown how easily we can slip into more primitive thinking patterns founded on just such assumptions.[6]

"According to Hume every representation of causality should ultimately be derived from the representation of mere coexistence. The two contents which have appeared together in consciousness with sufficient frequency are ultimately transposed through the mediating function of 'imagination' from a relationship of mere contiguity, of mere spatial coexistence or temporary succession, into a causal relation. But in truth scientific knowledge gains its concepts and judgments by an exactly opposite process. Through these concepts and judgments contents which are contiguous for immediate sensory impressions are progressively dissected and assigned to different complexes of conditions. In mere perception a specific state A in moment A1 is followed by another B in moment A2. But regardless of how often it is repeated, thus succession would not lead to the idea that A is the 'cause' of B – the *post hoc* would never become *a propter hoc* – unless a mediating concept intervened. From the state A thought isolates a specific factor α which it links with factor β in B. The α and β stand in a necessary relation to each other, a relation of 'cause' and 'effect,' of 'condition' and 'conditioned,' is not passively read from a given perception or number of perceptions…. Particularly the physical *experiment* on which causal judgments finally depend is always based on such analysis of an occurrence into different spheres of conditions, different strata of relations."

Scientists, in fact, seek out the matrices of causal relationships, and direct their primary interest to these.

"This isolating abstraction, which singles out a specific factor in a total complex as a 'condition,' is alien to mythical thinking. Here every simultaneity, every spatial coexistence and contact, provide a real causal 'sequence.' It has even been called a principle of mythical causality and the 'physics' based on it that one takes every contact in time and space as an immediate relation of cause and effect. The principle of *post hoc, ergo propter hoc* and *juxta hoc, ergo propter hoc* are characteristic of mythical thinking. Animals appear in a certain season are, for example, commonly looked upon as the bringers, the cause of the season."

To show how pertinent all this is to our problems of economic theory, I shall quote from a recent book of John H. Hotson, *Stagflation and the Bastard Keynesians* (p. 54): "The relationship of money and prices is often expressed in the form of the Equation of Exchange (EOE) developed by Irving Fisher: $MV \equiv PT$, where M represents the stock of money, and V is the rate of turnover. The triple band states that M times V is identically equal to P times T, where P is the price level and T is identically equal to P times T is the volume of money transactions. If, in the short run, the volume of transactions is fixed by the amount of production, employment and exchange people are engaged in, and V is fixed by payment

Constitutional Challenge re: the Bank of Canada

20/7/09

Hi, Richard:

I have often wondered why knowledgeable people fail to use a "writ of mandamus" to compel governments to do what legislation directs them to do.

Also, since people's juries are the most fundamental form of democracy, why knowledgeable people do not form such people's juries to examine and express opinion on existing and proposed legislation.

The purpose of juries is not merely to determine the guilt or innocence of people accused by the state, but also, as exemplified by the Morgenthaler (abortion) case, to overturn bad law.

Possibly, people's juries could also be used to examine, as would a coroner's jury, the administration or mal-administration of the law. All it would take is a venue, with non partisan people willing to hear all sides of a case, (stakeholders) and then give a verdict or make recommendations.

The resultant publicity might even attract attention from the media.

Kind regards,

Ed Goertzen

PS. We use the existing electoral democratic system to elect people, but we have no mechanism or system in place to give opportunity to voters to weigh in on formation of programs, policies and priorities.

21/7/09

Hello Ed:

Thanks for your comments. Are you suggesting that the "constitutional challenge" take the form of a "writ of mandamus"?

May I forward your comments to Bill Krehm?

Richard Priestman

21/7/09

Hi, Richard:

Certainly not to take the place of Mr. Krehm's challenge.

I suggest it as an alternate process that may only have publicity value.

Certainly, forward to Mr. Krehm.

Not being a lawyer, I would not know how the writ works. I only know that the writ is an option that may be invoked, but how? I know not. I think that it is invoked by a judge, on request?, and it compels the Crown to obey the law.

Unfortunately, the Crown always has the excuse that the law mostly "allows" it to do some things and does nor compel. Most people do not know that the "governing power" is the power to invoke, or not, the law. It is not all up to the bureaucracy.

It may be worth looking into by someone knowledgeable.

A long time ago I suggested that Connie Fogal make the claim that what the government was about to do, or did was *ultra vires*, that is, beyond the constitutional power of the Crown to do without legislation. She used the idea to mount a constitutional challenge.

Kind regards,

Ed Goertzen

habits and contracts requiring payment at fixed intervals, it must follow by mathematical necessity that M and P are directly proportional to each other. This, in itself, is not a 'quantity of money theory of the price level.' However, the essence of monetarism is the belief in 'left to right' causality, the belief that by and large an increase in the money supply causes a rise in the price level rather than the reverse.

"Since the rise of national income accounting, it is customary to express the equation of exchange as $MV \equiv PQ$, where Q represents real, or constant purchasing power dollar income and output, and PQ is the current dollar value of the output, thus Gross National Product, GNP.

"The remaining theories of inflation we wish to consider can likewise be expressed as truisms. Thus we may write: $MV \equiv PQ \equiv GNP \equiv C+I+G+(X-m) \equiv kW \equiv hB \equiv DPY+DGY+DFY \equiv jS$. Our new terms express that GNP is identical to the sum of Consumption (C), Investment (I), Government Expenditures (G) and Exports (X) less imports (m). GNP is also identical to some multiple of Consumption (C), Investment (I), Government Expenditures (G) Exports (X) less Imports (m). GNP is also identical to some multiple (k) of the Wage B ill (W) It is also identical to some decimal of Total Net Debt (B), and the sum of Disposable Personal Income (DPY). Disposable Business Income (DBY), Disposable Government Income (DGY) and Disposable Foreign Income (DBY)…. Finally, GNP is identical to some very large multiple (j) of my salary (S). Each of these identities may be expressed as a price level equation by dividing through by Q. Thus with rearrangement we have: $P \equiv V(M/Q) \equiv GNP/Q \equiv C+I+G+(X-m)/Q \equiv k(W/Q) \equiv h(B/Q) \equiv j(S/Q)$. It will be recognized that each of the expression to the right of an identity sign is merely an alternative definition of the price level. However, each expression may also be considered to be a causality statement. Thus, the first, or equation of exchange, states that the price level is caused by the ratio of money to real goods (times velocity) and will change as this ratio changes (unless the velocity varies). Skipping over the second term we come to its expansion in the third or 'excess demand' expression, that the price level will rise whenever the sum of expenditures on Consumption, Government and the foreign balance exceed the real output of the economy. Next we have the 'Wage Cost Mark-Up' explaining the price level as the ratio of the wage bill to real output (times k, or 'mark-up'). Next we have the 'excess debt' explanation and finally we 'explain' the price level as the ratio between my salary and real output times j. Now, all thee statements are equally true, but they are equally plausible as right to left' causality statements."

In short Hotson is playing spoil-sport and messing up a perfect application of mythical causality by applying some critical logic. That does not happen too often in our economic faculties. More generally the mythological thought patterns of primitive tribesmen that we all carry within ourselves are fortified by an uncritical reverence for the mathematical apparatus of science.

There remains, of course, the difficulty of the implied time sequence in any causal relationship – necessarily ordered in time – constitute an asymmetrical relationship. Equilibrium theory has gotten around that little difficulty with elegance. Let us listen to Alfred Marshall on the point: "It is necessary to face the difficulty of regarding the various elements of an economic problem – not as determining one another on a chain of causation. A determining B, B determining C, and so on – but as all mutually determining one another."[7]

Time is thus flattened out by positing equilibrium centers around which economic events oscillate – just as a pendulum does under the joint influence of its constraints and gravitation. When it has swung too far in one direction, it is drawn back to describe a symmetrical arc in the opposite sense. In this way we not only stick close to our center of equilibrium, but no less significantly to the fundamental pattern of mythological thought.

Let us turn to Cassirer for yet another basic feature of mythic thought.[8] "…The mythical concept of the attribute is most evident in the structure of alchemy…. Here every similarity in the sensuous manifestation of different things or in their mode of action is ultimately explained by the supposition that one and the same material cause is in some 'contained' in them. Alchemy for example looks on bodies as complexes of simple qualities from which they arise through mere aggregation…."

There is a complete parallelism here with the way in which conventional economic theory has viewed "inflation." Rather than examine the various factors that contribute to price rise in their diverse relationships, the price climb in itself in itself becomes the thing: by removing the attribute of climbing price without seeking its specific causes, we will be "licking inflation." That is why governments have pushed their economies to the brink of disaster with punitively high interest rates, credit restrictions, and system of price control that showed no curiosity. All this was to drive out the devil, pardon, the attribute of inflation.

In this perspective equilibrium economics could stand in the same relation to an economic science as astrology does to astronomy, or alchemy to chemistry. The only difference is that time presses. Disciplines able to slough off their mystic cauls some centuries back have created problems that only an economic science can handle.

End Notes

1. "The single comprehensive GNP figure is made up of factors (capital goods, government services, military expenditures etc;) which have widely differing meanings in diverse national contexts, and affect human welfare in uncertain ways according to individual tastes and desires. The conclusion is that even when two countries have the same GNP, say £100 Mn this identical figure may hide varying material and welfare standards in the two countries…. But the public knows of course nothing about these reservations when they are sold some dose of government intervention on the basis of a single GNP figure…. Some (academic economists) write popular articles and speak in plain language on the BBC on economic maters; the nature of the mass media permits them to mention GNP growth rates and numerate forecasts, but of course denies them a mention of GNP growth rates, and numerate forecasts, but of course denies them the opportunity to introduce the qualifying reservations they would ordinarily make to academic audiences. Such behavior constitutes misrepresentation." (Rubner, Alec [1970]. *Three Sacred Cows of Economics,* p. 16. London: Macgibbon & Kee)

2. Note in this connection the popularity of the expression "toolbox" in American economic literature.

3. *Economic Philosophy,* pp. 7-9. Chicago: Aldine Publishing Co., 1962.

4. *Philosophy in a New Key,* pp. 24, 28, Mentor Books: New York, 1948.

5. An exact parallel developed in pure mathematics with the recognition that every associate algebra is the equivalent of a matric algebra. "The essential point is the proof of this equivalence, i.e., the variables can be replaced by the transformational structures linking one set of variables to another, is brought out most naturally by explaining the correspondence, first noted by Poincare, between the elements of any associative algebra A over a field D and the linear transformations of a certain set." (Leonard Eugene Dickson, *Algebras and their Arithmetics*)

The very speech in which we communicate consists in large degree of such structures of transformation. "Where a precise world is lacking to designate the novelty which the speaker would point out he resorts to the powers of *logical analogy and uses a word denoting something else that is a presentational symbol for the thing he means:* the context makes it clear the thing literally denoted, and must mean something else symbolically…. If he says 'the king's anger flared up' we know from the context 'flaring up' cannot refer to the sudden appearance of a physical flame….

"Wegener (Philip Wegener, *Untersuchungen ueber die Grundfragen des sprachlebens)* calls such a word a 'faded metaphor' and shows…that all general words are probably derived specific appellations, by metaphorical use; so that our literal language is a very repository of 'faded metaphors.'" (Langer, op. cit., p. 123).

6. *The Philosophy of Symbolic Forms,* Vol. 2, *Mythical Thought* (1964) translated by Ralph Manheim, New Haven and London: Yale University Press, pp 44 et seq.

7. *Principles,* London: Macmillan Limited, 1936, pp. lxxx, 58, 81, 294.

8. Op. cit., Vol. 2. pp. 65, 68 and 60.

Our Central Banks Don't Even Know What They Are Talking About

Financial Post (22/07, "US Fed Outlines Pullback Strategy" by Janet Whitman) delivers what is meant as cheerful tidings, but is in fact most depressive. In the most literal sense the monetary authorities don't know what they are talking about – "inflation."

"The US Fed won't be backing off from policies aimed at stimulating the economy despite tentative signs of a recovery, Mr. Bernanke said.

"Mr. Bernanke, who spelled out the Fed's position in an opinion piece he wrote in yesterday's *Wall Street Journal* and in testimony before US Congress, said supportive policies would be 'warranted for an extended period' to prevent rising unemployment from thwarting a recovery.

"'At some point, however, as economic recovery takes hold, we will need to tighten monetary policy to prevent the emergency of an inflation problem down the road,' he wrote. 'We are confident we have the necessary tools to withdraw policy accommodation, when that becomes appropriate, in a smooth and timely manner.'

"To rein in excess capital, the Fed can boost the interest it pays on reserves, jack up the interest rates and take steps to reduce bank reserves.

"Wall Street has been eager to hear how the Fed plans to prevent a flood of easy money from leading to inflation.

"'He seems to have raised a level of confidence in the financial markets that all of the liquidity is not going to generate an explosion of inflation,' said Bernard Baumohl, chief global economist with the Economic Outlook Group.

"Economists said they don't expect the US Fed to start increasing interest rates soon.

"'Mr. Bernanke's emphasis on the grim state of the labor market suggests any tightening will not start until unemployment starts to come down,' said Ian Shepherdson, chief US economist with High Frequency Economics. 'On our reckoning, that means 2011 at the soonest.'"

Translated into greater frankness: "If when, and as, a recovery really sets in, when workers can find jobs again, so that homeowners can make payments on their mortgages, then all the illiterate lore that has replaced a workable economic theory will be carted out again to repeat on a deeper and still more dangerous scale this greatest of all crises since the 1930s. We base this grim certainty on the fact that the financial chieftains in the most literal sense *do not know what they are talking about.* I refer to the very meaning of the word "inflation."

Logical Proposals Cannot Be Flapped Over Like Pancakes

At this point, President Obama should be calling in a mathematician and a specialist in logic to pass judgment on the literacy of flipping around logical propositions like pancakes. Example: if I hold a loaded pistol to my head and press the trigger, I fall dead. However, from that you cannot deduce that if I have fallen dead, I have suicided. It could have been due to heart-failure, or a hundred other non-suicidal causes.

Applying this to our price level: if prices go up it is not necessarily evidence of too much demand to be filled by available supply. It could have been any of countless other causes. Nobody moving from a town of, say, 20,000 to New York City will be fool enough to assume that her cost-of-living will stay the same. Why then should you assume that it must remain the same when humanity is making such a move? The number of cities of more than five million people in the world has multiplied in the past two generations almost beyond counting. The expansion into other dimensions – whether it is the technology towards travel into outer space or into the very elements of matter. All this calls for ever more massive investment in human capital that only governments can make. Or the increasing life-span and hence an aging population in most leading coun-

LIFE STYLES OF OUR DAYS

Gut Statistics Like Those Out of the Early 1930s

National Post (7/3, "Charities feel pinch as donations decline as demand increases" by Megan O'Toole) informs us: "Minutes after the Good Sheppard Ministries on Queen Street East opens its doors to serve the afternoon meal, a lineup of people stretches out the door and almost around the building.

"It is a mix of old and young, homeless and recently laid off, and each in turn greets a smiling staff member serving up meatloaf, salad and garlic bread. The bustling cafeteria quickly fills up to capacity.

"'We're serving about 1,200 meals and snacks every day,' says fundraising director Adrienne Urquhart. 'That's the largest demand that we have seen to date in our services.' Demand has spiked 44% over the previous year, while an influx of overnight guests routinely fills all of the facility's 91 beds and spills over onto couches. On a daily basis, volunteers give out almost 200 pieces of clothing.

"But as more people feel the recession's pinch, she says, donations have been failing at the worst possible time.

"Every shelter in Toronto gets a per diem from the city, but they also rely heavily on independent fundraising through food drives, direct mail campaigns and special events. Donations to Good Shepherd's most recent Easter campaign, Ms. Urquhart says, plummeted by 17% – $83,000 compared with $100,000 a year earlier – with declines in both the number of donations and the average amount.

"It's a big chunk of money when you're trying to fund the services we're providing.

"Good Shepherd is not alone: charities across the city are facing increasing pressures as the economic downturn forces many to do more with less.

"A Daily Bread Food Bank report shows annual food banks visits in the Greater Toronto Area have broken the one-million mark for the first time. More than half the new clients surveyed said they were accessing food banks because of recent job loss or reduced hours of work. It also says three quarter of food banks' new clients says they have been selling assets or incurring debt to pay for basic needs, such as food and rent."■

Are We Being Salted Down by our Food Corporations?

The Globe and Mail (23/07, "The Cereal Killer Study finds food has more salt in Canada" by Carly Weeks) blows its whistle on a conspiracy that is helping undermine the health of Canadians: "It has no candy coating or cartoon mascot, which makes Kellogg's All-Bran cereal a favorite among health-conscious consumers. But with all the salt it contains, a box of Sugar-Os may be the healthier choice – in Canada at least.

"One bowl of All-Bran sold in this country contains 620 milligrams of sodium, or more than the daily recommended intake for people age nine to 50. In the US, one bowl has just 160 milligrams of sodium.

"And it's just not cereal.

"Burgers, submarine sandwiches and onion rings sold in Canada by international restaurant chains contain significantly higher levels of sodium than the same products sold in other countries, reveals a new report that is raising new questions about efforts to reduce the country's dangerously high salt consumption, a leading cause of high blood pressure and cardiovascular disease.

"'Most people have no idea how much salt they're getting,' said Norm Campbell, a professor of medicine at the University of Calgary and Canadian Chair in Hypertension Prevention and Control. 'Canadians should be outraged by this.'

"The analysis was compiled by World Action on Salt and Health (WASH), an international health advocacy organization whose membership includes prominent experts who specialize in hypertension. Using nutrition information available on the websites of food manufacturers, WASH compared more than a dozen fast-food and processed-food items available in a variety of countries around the world. Although the survey was limited to a handful of products, differences in sodium levels from one country to another can likely be extrapolated to a handful of foods, said WASH coordinator and nutritionist Katharine Jenner.

"In every product studied, the survey found that the amount of salt differs from country to country. In many cases, sodium levels are highest in Canada and lowest in Britain, which launched an aggressive campaign several years ago to reduce salt consumption.

"The report underscores the fact that Canadians are exposed to much higher levels of salt in common fast food items, such as the common fast-food items, such as McDonald's Big Mac, than people who live in other countries. For instance, onion rings sold by Burger King in Canada contain 620 milligrams of sodium per serving, the highest of any country surveyed, compared with 200 milligrams per serving in Britain.

"Burger King Corp. did not respond to a request for an interview. Kellogg Canada Inc. also declined an interview request, but said an e-mail statement that 'geographical variances in consumer taste preferences and ingredient supplies' explain why some of the company's products contain different amounts of sodium needed to meet consumers' taste preferences in different countries.

"'These companies could quite easily reduce salt in all of the countries to the lowest level that is currently there,' said Graham MacGregor, chairman of World Action on Salt and Health and a professor of cardiovascular medicine at St. George's Hospital in London.

"Everybody needs salt, also known as sodium chloride, to live. But the average Canadian consumes nearly 3,100 milligrams of sodium a day, according to Statistics Canada, more than double the daily recommended amount for adults.

"But the problem isn't in the salt-shaker. Up to 80% of the sodium Canadians consume comes from packaged or processed food, including fat-free salad dressings, breads, canned vegetables, and pre-made meals.

"A growing number of experts, such as Dr. Campbell, are calling for immediate action to educate consumers about the dangers of excessive sodium consumption, along with measures to encourage or force food manufacturers to bring salt levels down. The federal government has created a working group to examine the problem and propose solutions. but it has yet less to release a plan."

Meanwhile it seems to be having difficulty in finding the funds to keep up with the growing hospital needs of a growing aging population. Should it not be examining how dealing with its besetting problems in groups might achieve some helpful results?

W.K.

Central Banks *from page 15*

tries. Or the increasing equality or other arrangements between the sexes.

If economists even in their dreams imagine that all this can be accommodated within a flat price-level misnamed "non-inflationary," anything having to do with logic is scratched out in advance.

The challenges to this were largely centered in France in one way or another. I was drawn to the work of French economists and they to an extent to mine. I had reached the conclusion that our price structures are not only determined by market forces but by structural layers of what I call the "social lien." A paper setting forth the arguments for this I prepared and sent blindly to some 30 publications on economics. One of these, *La Revue Économique* – the leading publication on economics in France at the time but long since disappeared – purchased the article and carried it in its issue of May 1970. It was only by reading that and many other French books and papers that I came to understand why my ms. had been snapped up in France.

Two economists working independently in different areas had studied the statistics of price movement and economic activity and reached the conclusion that a still undiscovered factor other than quantitative supply and demand had been at work in determining price movement. My paper had identified the factor that they were missing to explain the discrepancy.

My effort was favorably reviewed in at last a half-dozen countries including a note in the economics journal of the University of Cambridge.

Harvey Wilmeth, a COMER board member and professor of economics at the University of Wisconsin, even improved on my views by pointing out that in fact the cost of public services enters the price level not once but twice – once through the costs of the private producers and again in the tax component in the government's cost base for the private products it purchases. I confirmed this through the relevant infinite series, of government tax base that enters its own costs.

One of the most important results of my French relationship was my close friendship with one of the leading French economists of the times now dead for over a decade. Amongst his many achievements was the concept of the "dominant revenue" which is essential for an understanding of the present world crisis. This holds that in every economic period the revenue of the class in the economic saddle is taken for the index of the welfare of society as a whole. Until the reform law repealed the high-tariff *Corn Laws* of the mid 1830s, the rents of the large landowners heavily protected by tariffs filled that role.

By the mid-1830s the industrialists, enjoying a virtual world monopoly as the first to introduce steam-driven machinery in their factories, had the economic might to force low tariffs. Leading free-traders like the broker David Ricardo had made full use of the labor theory of value to formulate a convincing free trade doctrine. That was fine so long as the British working class had been illiterate, but they were learning to read, and London by mid century Britain was swarming with socialist and anarchist refugees from just about every country of Europe, refugees from the barricade struggles that had taken place in almost every capital of Europe. Among these refugees were Karl Marx and Friedrich Engels themselves. Before long under their influence and often on their initiative soap-box meetings were being held in Hyde Park almost within earshot of Buckingham Palace itself. That had been relatively unthreatening so long as British workers were not able to read.

But they were quickly becoming literate. Time therefore for a radical change of the "dominant revenue" once again. In three capitals within a few years, quite independently it shifted from a labor theory of value to and the concept of value seen as originating not in the grimy factories but in the elegant shopping galleries, where value was see determined by the degree of enjoyment that the consumption of a product gave rise to. To add to its persuasiveness, it was presented with a crude application of marginal calculus, mistaken as a guarantee of scientific value.

In fact the empirical input that any mathematical technique can bring to any economic situation is zero. It is powers of analysis of maths that is infinite.

Yet such is the power of a "dominant revenue" is indicated by the stand of the marginal utility theory of value people that unemployment did not and could not exist in Britain. If workers were unemployed it was strictly because having compared the respective alternatives offered they simply decided that they could find more enjoyment with delights of leisure in their parlors than going to work at the wages offered. Hence, there was then no unemployment in Britain.

Even a professional skeptic devoted to Fabian socialism like George Bernard Shaw wrote a work linking marginal theory to "The Intelligent Woman's Guide to Socialism."

There is little doubt that President F.D. Roosevelt in the US when inaugurated for his first term was able to move carefully in the direction of significant reforms only because those whose class interest had been protected by the dominant class revenue, were themselves abandoning its flagship. The only banker in his first cabinet was not from Wall Street, but from Salt Lake City, and mighty industrialists like Henry Ford and Thomas Edison had turned their backs on the banks. There is clearly no comparison between the position of President Obama today and that of Roosevelt in 1933.

W. Krehm

On Shortening the Delay in Refunding the Economy

One of the problems of President Obama in getting the economy moving again is that he has surrounded himself with advisers sworn to fidelity to the "dominant revenue." Refunding the economy lifting it out of the chasm depends on getting our banks patched up with government funds at which point they will hang on to government funding until a favorable opportunity arises for them to gamble again and win big.

We, on the contrary, have formulated a package for utilizing the unused investments in human capital that is not even treated as an investment and thus of capital on our books. It has already been written off as spent (rather than invested) and carried at one dollar.

But the same principle on a smaller scale appears in a reportage in *The Wall Street Journal* (7/07, "Boost in Food-Stamp Funding Percolates Through Economy" by Roger Thurow and Timothy W. Martin): "Davenport, Iowa – The lush red strawberries caught the attention of Rachel Patrick, a mother of five shopping at a farmers market along the Mississippi River here. She selected two cartons and ignited a little chain reaction that is an important part of President Barack Obama's economic stimulation plan.

"Ms. Patrick handed a plastic card loaded with her monthly food-stamp allocation to farmer Ed Kraklio Jr., who swiped it through his electronic reader. Mr. Kraklio now regularly takes in several hundred dollars from food-stamp sales, a vital new revenue stream that has allowed him to hire another assistant to help tend a cornucopia of fruits and vegetables. The new worker, in turn, spends her income in nearby stores, restaurants and gas stations.

"The president's stimulus plan has been aimed primarily at the top of the economy, pumping money into banks and car companies and state and city governments. But it has also put more money in the hands of the poorest Americans, by boosting monthly food-stamp allocations. Starting in April, a family of four on food stamps received an average of $80 extra.

"Money from the program – known officially as the Supplementary Nutrition Assistance Program – percolates quickly through the economy. The US Department of Agriculture calculates that for every $5 of food-stamp spending, there is $9.20 of total economic activity, as grocers and farmers pay their employees and suppliers, who in turn shop and pay their bills.

"While other stimulus money has been slow to circulate, the food-stamp boost is almost immediate, with 80% of the benefits being redeemed within two weeks of receipt and 97% within a month, the USDA says.

"The quick influx of cash into the economy reflects the often desperate situation faced by millions of households struggling to put enough food on the table. For many families, monthly food-stamp allotments rarely last more than a few weeks, leaving them with dwindling grocery supplies – and sometimes bare cupboards – by the end of the month.

"Angie Minx rushes to her Save-a-Lot grocery store on Chicago's South Side at the start of every month, when her new food-stamp allocation appears on her card. So do many of her neighbors.

"On a recent shopping trip, she headed straight to the fresh produce section. Before her increase in April to $606 from $525, Ms. Minix said she would rarely even troll the fresh-food aisles. Now, she talks about how she has introduced her two sons to cauliflower, cabbage, lettuce and cucumbers.

"Employed by the state as a home aide, she has seen her hours cut and her mortgage payments rise. Still, the food-stamp boost has increased her purchasing power.

"I can't buy a new car, but I can feed my family.

"For years the food-stamp program was

plagued by criticism that it was an inefficient way to help the poor. Many who qualified wouldn't apply because of a lack of information, daunting paperwork and the embarrassment of handing over stamps in a grocery checkout line. And it did little to increase access to more nutritional food, since fresh produce remained scarce in poor areas.

"In recent years, though, registration has been streamlined; many food pantries offer information and direct sign-up services. The switch from stamps to plastic offers a cloak of anonymity. Meanwhile, more farmers markets offering fresh produce have adopted the technology to accept the cards.

"Nationwide, enrollment in the program surged in March to about 33.2 million people, up by a million since January and by more than five million since March 2008. In a recent research report, Pali Capital Inc. estimated that food-stamp spending will increase between $10 billion and $12 billion to $34.6 billion in 2008.

"For grocery stores and farmers markets, the added food-stamp revenue has helped offset slower sales to other consumers.

"'When we look at the acceptance of food stamps, it becomes part of a larger and longer strategy for us,' says Ken Smith, chief financial officer of Family Dollar Stores Inc., a Charlotte, NC, chain with 6,600 outlets in 44 states. A recent survey estimated that about 20% of Family Dollar customers receive food stamps.

"Farmers markets in Iowa have been particularly aggressive in courting the business of stamp recipients, At the Davenport market, food stamp purchases have boosted business at Sawyer Beef. As farmer Norman Sawyer's sales increase, he plans to buy more fencing and water tanks to improve grazing areas for his cattle, 'This has been a good deal for us,' he says."

W.K.

In the Footsteps of Alexander the Great Et Tutti Quanti

The Globe and Mail (21/07, "The Afghan Mission: going, going, gone" by J.L. Granatstein, senior research fellow of the Canadian Defence and Foreign Affairs Institute) offers one of history's dangerous corridors that some of the greatest military powers and leaders have eventually learned to pull out of.

"The latest opinion polls on Canada's role in Afghanistan are very clear. Support for the war is dropping as Canadians see the casualties rising and the prospects for quick success declining.

"A majority of those polled by EKOS and Ipsos Reid want Canadian troops out by 2011, exactly as the House of Commons resolution in 2008 said. This does not mean Canadians do not support their troops; they do. Nor does it mean they want to cease efforts to help in the development work needed to bring Afghanistan into the modern world. But they do not wish Canadians to continue their role in fighting.

"This is not an unreasonable position. Canada has been in Afghanistan since 2002 – in different roles but with armed troops on the ground (and now in the air, too). The Canadian Forces have lost 125 men and women, and many more have been wounded in body and in mind. The price has been high and as the insurgency spikes this summer, reasonable citizens can raise hard questions about the long term value and results of the Canadian mission.

"The army, too, has its concerns. With only 20,000 soldiers in all and with a rotation of troops every six months, it has become a terrible struggle to find and train the battle troops in the field. Some soldiers are already doing their third rotation into Kandahar; by 2011, some may have completed five tours. Think of the effects of that on families at home and on the psyches of the soldiers.

"Moreover, the army's equipment in the field, its light-armored vehicles and Leopold tanks, are being worn down by continuous operation in harsh conditions. Improvised explosive devices not only kill soldiers – they seriously batter equipment.

"But will it be as easy to get out of Afghanistan as Parliament and the public want? First, there will be a sense on the part of the Afghans that Canada is cutting and running. Some of our NATO allies will use our departure as an excuse to do the same. That is galling, considering how little many NATO members have done in the war and the caveats that have kept most of those that have sent troops out of harm's way.

"And then there are the Americans. The Obama administration has made the Afghan war its own – out of Iraq (soon) and into Afghanistan (now). The US Army is taking command of the fighting and NATO is being pushed to the side, but Washington will still want allies. US pressure has been gentle so far; we can expect that to increase and it will require some toughness to say no to Barack Obama. That Canada might have an election in 2010 will only complicate matters. So what do we do? If the Canadian government stays on its present course of getting out in 2011 – and both the opinion polling and the government statements suggest it will – the battle groups will come out, as planned. But what about the Provincial Reconstruction Team? Canadians approve of reconstruction assistance in Afghanistan, and the reconstruction team delivers just that. Does it stay? And if it does, can it function without military protection?

"And what about the Operational Mentor and Liaison Teams (the wonderfully names Omelettes) that help train the Afghan National Army battalions? If the insurgency is to be defeated, the Afghan soldiers will be required to function at a high level. There will be support for keeping a substantial number of Canadian Forces trainers in the field. The same applies to the police mentors. There might even be government support for continuing to operate helicopters there to help the allied forces to get off the IED-infested roads.

"So where will we be in and after 2011? No one, of course, can forecast the course of events in Kabul, Washington and Ottawa with confidence two years ahead. But no one should assume that that Canada's military presence will end at one stroke. What does it all come down to? There will be Canadians in Kandahar for the foreseeable future."

It could have been foreseen, but it wasn't One can imagine the Macedonians under Alexander the Great, or the British – or the Soviets who awoke to the problem a little late. Perhaps the best answer is increase the history lessons in high schools and universities here, and watch carefully what gets passed off as history's lessons.

W.K.

RENEW TODAY!
(SEE PAGE 2)

"Government Tightens Its Derivatives Vise" — A Wee, Wee Bit

From *The Wall Street Journal* (15/07, "U.S. Tightens Its Derivatives Vise" by Liz Rappaport, Carrick Mollenkamp and Serena Ng): "The (US) Justice Department's investigation into credit-default swaps is homing in on the role of Markit Group Holdings Ltd. and its ownership by a group of banks that control a large amount of pricing information in the $26 trillion market.

"In recent weeks, the Justice Department's antitrust division contacted Markit and several large banks that own the company, seeking information on the banks' ownership of Markit and what data they provide to the company, according to people familiar with the matter.

"The interest of the Justice Department reflects the growth of derivatives from an obscure corner of the credit market into a world-wide business that is drawing increased scrutiny. As the market grew, Markit became the dominant provider of pricing and information.

"The probe dovetails with a push by the Obama administration for more transparency in the market, which was blamed for helping deepen the credit crisis last year. Credit-default swaps are effectively insurance contracts designed to protect investors against losses on bonds or loans. The contracts are now more often used to speculate on the health of an issuer.

"Investors and competitors have groused about the dominance of Markit and its owners, which comprise the top dealers in the credit derivatives markets, including J.P. Morgan Chase & Co., Goldman, Sachs Group Inc., and Credit Suisse Group. They complain that Markit has exclusive access to key pricing information that is handed to it by banks, preventing them from producing competing products. As well, Markit runs key indexes that now account for much of the trading in the market.

"They include the ABX indexes, that track subprime mortgages, and CDX index of corporate credit default swaps, both of which became a fixation for many as markets cratered last year. Markit's [products extend beyond derivatives to stocks, commodities and rates.

"While the Justice Department didn't specify its concerns in letters it sent, the fact that its anti-trust division is leading the probe is behavior rather than market manipulation."

That is like investigating a mass murder in terms of whether adequate competition existed amongst the killer's access to the prey.

"Markit issued a statement saying 'it has been informed of an investigation by the Department of Justice into the credit derivatives and related markets.' The agency asked each bank for information on its participation in the credit derivatives market, its ownership stake and the type of data provided to Markit, according to people familiar with the letters.

"Markit shareholders also include Citigroup Inc., Deutsche Bank AG, Bank of America Corp., Barclays PLC, UBS AG, Morgan Stanley and HSBC Holdings PLC and others. Representatives of the banks declined to comment.

"'Several market participants have complained behind the scenes about Markit's behavior to the credit default swap market,' said Tim Backshall, chief strategist of Credit Derivative Research, which studies the credit default swap market. It is problematic that 'the dealers who make the markets should be in charge of the pricing service,' Mr. Backshall said."

Competitors Encounter Headwinds

"Competitors to Markit say they have run into headwinds trying to develop rival products and investors have complained that dealers have too tight a grip on the market. From its London headquarters, Markit collects credit default swap pricing data from credit market dealers and then compiles and distributes it to clients early the next morning.

"The firm was founded in 2001 by Lance Uggia, a credit trader at TD Securities in London, a credit trader at TD Securities in London, growing out of a database Mr. Uggia began to collate information on credit derivatives. He persuaded TD to let him form a separate unit and soon Markit had equity investments from major banks. As credit derivatives ballooned Markit became an integral part of the market."

We suppose that if we were patriotic enough in a very brainless pseudo-patriotic way we Canadians should take pride in the key role of a deregulated Canadian bank in founding an institution like Markit. Less known than the role of other Canadian banks in organizing some of the worst off-the-books schemes, it should not be forgotten.

"The Justice Department's inquiry has raised eyebrows among some observers who wonder how this will intersect with proposals from the Obama administration to overhaul regulation of over-the-counter derivatives. The probe, while in its early stages, also underscores the renewed vigor of the Justice Department under Assistant Attorney General Christine Varney. The department has ramped up its investigations into potentially monopolistic practices at cell phone carriers to hiring within Silicon Valley in a range of takeover deals.

"A centerpiece of the Obama administration's proposals involves requiring that all derivatives with 'standardized' terms be cleared centrally through regulated clearinghouses and traded on exchanges or regulated electronic platforms. Trades on Markit's swap indexes and many contracts tied to well-known corporate names are considered to be standardized. As well as clearing, the banks have a stake in protecting the proprietary nature of Markit's indexes, which comprise at least a third of the market's overall trading volume.

"The ABX indexes gave investors the ability to bet against the mortgage market for the first time. They surged in popularity as the market began to melt down. And like the skyrocketing prices of swaps on financial institutions like American International Group Inc. or Morgan Stanley last fall, the CDX became a key indicator of coming trouble.

"'These market indices are widely used and have a tangible role in how credit is priced across all the markets,' said David Havens, managing director at Hexagon Securities."

And there is a further detail that seems to have escaped all conventional economists, that COMER has pointed. out. You can only insure what is "risky," but not what is *wrong*, i.e., mathematically incorrect. The proposition 2 + 2 = 5 is not "risky" but incorrect mathematically. Insure that for enough money and both the insurer and the insured will go bust. With certainty. And that is what Wall Street was up to.

William Krehm

In the Convulsing World Economy, to Make Enough Sense to Keep Going, Social Infrastructures Must be Regarded as Social Investment

The lesson that President Obama is finding a bit difficult to assimilate is also missing in Guinea and other metal-rich lands with mining potential in Africa.

The Wall Street Journal (7/17, "Mining Giants Beat Hasty Retreat from World Stage" by Robert Guy Matthews) lets us in on a big secret: both the once mighty world mining organizations, governments in Africa lacking the infrastructure to turn on the lights in their schools as well as the railways to haul ore, and the world's largest mining corporations will have to join in sensing that social infrastructure, more than a luxury, are the very means of society's survival: "Simandou, Guinea – In a sun-baked field carved into a patch of lush forest here stand a half-dozen hulking mining machines shut down earlier this year. Nearby, military barrack-style housing for 200 workers sits abandoned.

"'We were building a country-changing project,' says David Smith, head of Guinea operations for mining giant Rio Tinto PLC. But that was before the global commodity boom went bust. Late last year, the Guinean government stunned the mining industry by telling Rio Tinto that it wasn't moving quickly enough on its $6 billion project to develop the world's largest iron ore reserve in the west African nation. It stripped Rio Tinto of 50% of the mine and gave them to another company.

"BHP Billiton, the world's largest miner, is scaling back aluminum operations in Africa, turning attention away from Russia and beefing up copper, uranium and gold mines in South Australia. In June it entered into a joint iron-ore project agreement with Rio Tinto in the Filbara region of Australia valued at $10 billion.

"'We want to focus, principally in our backyard,' said Marius Kloppers, BHP's chief executive officer.

"Not long ago, Xstrata PLC was trying to take over a palladium producer in Africa and several gold companies flooded Tanzania, Zimbabwe and Madagascar looking for riches. Now most of those plans have been dropped or put on hold as governments there begin tacking on new contract terms.

"'Mining companies are no longer willing to take the risks,' said Claire Divver of Xstrata, which abandoned its plans for the African Palladium venture. Others are also pulling back.

"Xstrata's new strategy is to grow through acquisitions rather than expensive and risky new mines. Last month it sent a letter to its larger competitor Anglo American FLC proposing a merger of equals. Anglo has been lukewarm to the idea. Brazil's Vale SA, the world's second largest miner, is likewise considering Anglo as a possible acquisition target and more conservative way to grow.

"In 1996, Rio Tinto's exploration team was invited to Guinea by the mining minister to perform initial work to find iron ore. By 2000, Rio won the rights to mine 300 square miles of what promised to be the world's largest reserve of unexplored iron ore….

"Rio's winning bid included $3 million in advanced taxes, an option for the government to acquire a 20% equity interest in the project, royalties of 3.5% and annual contributions to the local community. In all, the company expected to pump $6 billion into the country's economy and begin producing ore in 2013.

"'We will succeed here,' Tom Albanese, Rio Tinto's CEO told investors at a mining conference in Perth, Australia, in early 2008. 'Rio Tinto knows how to operate in a difficult environment.'"

No Plumbing or Power in Canakry's University

"Still, the hurdles were huge. With a gross domestic product of just $4.8 billion, Guinea has few skilled workers and woeful infrastructure. The main university in the capital city, Canakry, has no electricity or working plumbing, and residents are forced to burn trash on the streets. In addition to exploring for ore, Rio Tinto had to plan and start building a cross-country rail line and also construct a brand new shipping port. Meanwhile, the mining ministry was in turmoil, going through a series of mining ministers, two of whom were forced to make restitution to the government after facing embezzlement accusations.

"Rio Tinto also had its own problems. The company ran into financial troubles last year, brought on by the commodity bust. Rio had shaken off take-over advances from its rival BHF Billiton, but in the wake, it was left with heavy debt from its earlier acquisition of Alcan, an aluminum maker. To conserve money, Rio was forced to slow down some development at its nascent Guinea operations.

"In June 2008, Sam Mamady Moumah, the general secretary of the Guinean president, sent Rio a letter, admonishing the company about the mines' development progress. By December a new president was in place and the government rescinded half of Rio's mining area and transferred the rights to UK-based BSG Resources Ltd., which already had bauxite interests in Guinea.

"Rio said that since then, Guinea has treated the decision as final and has refused to meet with Rio officials to discuss any changes….

"The government's action made the project unfeasible in Rio Tinto's view because the reduced output wouldn't support the investment needed. Rio Tinto, which had been spending $30 million a month, began pulling up stages this year.

"Still hoping that the government will change its mind and in an effort to demonstrate its commitment to the country, the mining company continues building roads, schools and hospitals. It estimates it is spending $10 million a month there, but isn't sure how long it can keep it up. Rio has actually spend more in Guinea than required under its contract….

"Rio Tinto isn't without allies. Local villagers miss the work the company was providing and some village leaders have appealed to the government to settle."

Even across class barricades there are crucial times when basic human interest must prevail. We are at one such today.

W.K.