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Business Models Don't Have to Make Sense

Economic Reform readers may remember my characterization of the business model of an almighty private banking system deregulated to acquire interests and hence access to the cash reserves of non-banking "financial pillars" maintained for the needs of their own businesses – stock brokerages, insurance, and mortgages, credit cards or whatever.

Once they have access to these, they use their cash base for applying the "bank multiplier." The latter – until a few decades ago described in every university textbook – is no longer known to economists today. This is the volume of credit a bank can create supported by the cash or near-cash in its vaults (because it moves inversely to the change in the benchmark rates set by the central banks).[1]

That suggested to President F.D. Roosevelt the way of reviving the banking system, much of which had already shut its doors by the time of his first inauguration. To address the problem, Roosevelt shut down all banks for a month, listened to every economist who had advice to give, tried earnestly to understand what it was that they were talking about, and miraculously by well-focused good intentions actually got to the bottom of the problem. When you contrast the degree of the ultimate success of this well-intentioned man of little economic background with the futile straying of highly learned economists today, it is hard not suppressing a shudder. The accessibility of our history is one of the most crucial bits of weaponry in existence. Control that and a social group can undermine world society itself.

What Roosevelt came up with was known as the *Glass-Steagall* legislation that forbade the banks to acquire interests in any of the non-banking "financial pillars," e.g., notably stock brokerages, insurance, or mortgage companies. The reason: once it had access to any of these a bank would lay hands on its cash reserves held for the needs of its own business, and use them as cash base for credit-money creation. Each time you acquire control or a large interest in another non-banking "pillar," add a floor to the edifice. The bank capitalizes the capital value of its expanding empire, and capitalizes the growth rate. To maintain that capitalization it must move all the more quickly with the next floor of the edifice.

What you end up with is the equivalent of a skyscraper, with an elevator that can only move upward, and must do so ever more quickly or the capital value achieved will collapse.

This results in what I have described as a skyscraper of storeys, with elevators running at ever accelerating speeds only upwards, never downwards.

Using Hunger to Build Castles of Wealth

Now we learn that the same model can be applied even to a shriveling economy. Where there is enough hunger, why should it not be convertible to build structures of wealth? As was done with debt and misery during the unprecedented growth that we have so clearly left behind us.

Thus *Globe and Mail* (27/01, "Hungry Times, and McDonald's is loving it," by Grant Robertson) sets the pattern: "'The trends are going our way,' Mr. Skinner. Chief and Executive Officer Jim Skinner, basing himself on the experience of the past few months, has reason to be bullish. Though McDonald's has often declared

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Sense *from page 1*

itself to be depression-proof, the down-turn has become so deep it has turned into a growth opportunity for the chain."

Just like the banks that had to keep on growing bigger, bigger, in order not to collapse faster, faster, to continue capitalizing on the ever more brainless rate of growth.

"'The trends are going our way,' Mr. Skinner said yesterday. He told analysts on a conference call that quarterly sales rose in each of the company's markets around the world, and more than 7% globally, although profit was hurt by exchange rates."

That I and many others would consider an unfortunate oddity of a world no longer on a gold currency, and all subject to bankruptcy and unemployment but we are sure bankers allowed the freedom will find the means of bottling that as well for higher profit.

"Record numbers of customers walked through the doors of McDonald's outlets during the fourth quarter, with the average number of daily visitors topping 58 million at its 31,000 outlets by the end of 2008. Like Napoleon bestriding one of his victorious battlefields, Mr. Skinner counts the victors who might also be taken for the victims. 7.2 was the increase in global sales, 5% in North American sales, 7.65 in European sales, and 10% in Asia, Middle East and African sales." That suggests that Mr. Skinner may be counting the victims rather than the victors.

Note the strategies: "Preserve the value menu.[2] Faced with higher dairy costs in recent months, McDonald's considered raising the price of its double cheeseburger, which accounts for 40% of sandwich sales on its value menu in the US. Knowing the item brings people in the door, McDonald's instead cut corners and removed one of the two slices of cheese on the burger o keep the price down. Profit was preserved by preserving class distinctions, somewhat faded.

"McDonald's has been aggressively pushing its muffin-and-coffee combo this month for $1.29.

"After economic good times come to an end, the chain is hoping to attract customers, looking to go downtown for a cheaper cup of Joe.

"McDonald's is adding more than 1,000 new stores to take advantage of consumers looking for cheap food in a recession. North America will get 165 new stores, most of them in the US. Europe will see 245 and Asia, the Middle East and Africa will get 600. CEO Jim Skinner says the company has the access to capital to fund the expansion.

"'This is the time to go big,' said Douglas Reid, professor of Strategy at Queen's School of Business, noting that companies like McDonald's and Wal-Mart are able to expand their customer base in a turn-down.

"One problem the company faces is higher food costs. McDonald's has cut corners, knowing that its cheap fare is what has been getting customers through the door.

"In one recession strategy, McDonald's took one of the two slices of processed cheese off its double cheeseburger to keep the burger on the value menu. Raising the price would have hurt sales of one of its most popular sandwiches, Mr. Skinner said."

Why Not Swap Loaned Eye-glasses for Food?

Knowing what we have learned from the current economy elsewhere, we can almost safely foretell the lending of magnifying eyeglasses that will make that lonely chief slice in the salvation sandwich look much, much bigger than it in fact is.

"Cheating?" Perish the thought. We hereby baptize it as "joy enhancement," and so it is positively defined. So long as there are other senses to be brought into the play, don't count the all-performing market out.

Or if it is infrastructure that the developer's heart longs for, what is wrong with building for the four-abreast client awaiting their turn to the soup-kitchens in undersidewalks tunnels leading to impressive pillars and stairs leading to the soup kitchen itself – possibly out to McDonald's.

As long as the market rides high even at its lowest, there should be no cause for despair.

W.K.

1. "Near-cash" is short-term interest-earning credit called "near-cash" cash rather than plain cash rests in these other non-banking financial pillars.

2. "The double cheeseburger makes up 40% of the sales on McDonald's value-meal menu, which accounts for almost 14% of its revenue, and is a key weapon against other restaurants in the downturn.

"Naturally dieticians figure a recession will push people to eat more fast food. Instead of going to other restaurants they may have frequented, they still may wish to dine out, but will choose less expensive fare, said Susan Evers, a professor of nutrition at the University of Guelph.

"The $985 million profit McDonald's posted in the quarter was down from the $1.27 billion it made a year ago. However, those previous earnings were boosted by a large tax gain. Meanwhile, this quarter's earnings were hit by exchange rates as the higher US dollar hurt international profits.

"But the sales trends, including a 5-per-cent increase in North America and a 7.6% in Europe, have helped bolster Mr. Skinner's belief that 2009 will be a good year for the chain."

Education Helps a Society Leverage Every Other Investment It Makes, Be It Medicine, Transportation or Alternative Energy. It Appears the Best Single Bet a Society Can Make.

That sounds like an unacknowledged quote from something I sent to *The Times* within the past month – as I in turn make a point of gleaning from *The Times*. However, regrettably the writer left out a crucial part of the quote. Without it the project on which the survival of our society depends won't fly. Proper accountancy – accrual accountancy – brought back from Muslim lands to Europe by the Crusaders almost a thousand years ago, begins by entering twice every transaction that an investor makes – once the debt incurred in making the investment is "amortized" over approximately the foreseeable span of usefulness of the asset built or purchased. The asset acquired is "depreciated "over that period of its foreseeable usefulness. In that way the investor can follow the success or disappointment of the investment. Accrual accountancy amongst other things has drawn the praise of one of the world's great poets, Goethe – for its very elegance.

Yet until 1996 in the United States and 2002 in Canada, these two governments like those throughout the world with the exception of a couple in Scandinavia for short periods used what is known as "cash accountancy." By this the cash laid out for the government investment was carefully "amortized" over its likely term of usefulness, but the asset value of the investment itself was "depreciated" in a single year. Beginning with year two, the asset was carried on the books at one dollar – enough to remind the auditors that the government simply had not forgotten about it.

In fact it served a double purpose. It created the impression of a large budgetary deficit, where nothing of the sort existed. And it made for some highly profitable privatizations. The well-connected could go to church with the swagger of a philanthropist who from the overflow of his charity had just paid 1000 times "book."

All that had served to get the American economy out of the very deep hole into which it had landed when disregarding the *Glass-Steagall* legislation brought in by President F.D. Roosevelt in 1933. F.D.R. had proclaimed a bank moratorium after his first inauguration because 9,000 banks had already shut their doors. By what black magic? Just plain double-entry accountancy. In 1996 physical investments of the US government were reworked on the federal books to conform to accrual-accountancy, and with the process carried back to 1959 well over a trillion dollars of federal assets turned up as though from nowhere. That brought down interest rates, and revived the economy, giving President Clinton a second term and prolonged the high-tech boom almost towards the end of the second millennium.

Introducing Accrual Accountancy

There is a reward for a nation knowing its history, and a penalty for ignoring it. Especially when recent history spells out the solution to what has seemed an unmanageable credit crisis that threatened to engulf the world for the lack of accountancy worthy of the name. Until 1996 it was society's physical investments that were lost track of in this way. But in 1996, merely by recognizing the physical capital invested by the federal government and handling it with the accounting principles that the law imposes on private corporations, the debt crisis disappeared.

That was only 13 years ago, and spoonfeeds us the solution to our present economic crisis. It needs no new bad debt or new good debt. Just some elementary accrual accountancy applied to human capital precisely as was done with the government's physical capital in 1996 in the US and in 2002 in Canada.

But these are facts that for deep reasons it is difficult for ordinary politician to look in the eye. No matter how grave the economic difficulties to be overcome, the interests of those in the saddle seems to take precedence even when in despair proper accountancy is brought in, it is simply misnamed. Thus when accrual was brought in to the federal books in 1996 it appeared in the Department of Commerce books under the heading of "Savings," which it was most definitely not since that implies cash or near-cash – i.e., interest bearing short-term debt of the government.

One of the most valuable lessons to have come out of World War II was that investment of government in human capital – which would include health, the environment, education, social services – was the most valuable investment could make. The proof could hardly have been more persuasive. As soon as the war was over, Washington sent hundreds of economists to Japan and Germany to study *in situ* the damage to foretell how long it would be before these two great defeated powers could recover sufficiently to become the keen competitors they had been. In 1961 one of these, Theodore Schultz of the University of Chicago wrote a study explaining why he and his colleagues had overestimated the delay before the two ex-Axis powers would have rebuilt their exporting powers. "Our mistake was we concentrated on the physical destruction and overlooked that the highly educated, disciplined work force had come through the conflict basically intact. From this Schultz concluded that investment in human capital is the most productive that a government can make.

I have noted that the investments made by the US federal government and recognized only in 1996 amounted to well over $1 trillion. Today, 12 years later, it is no understatement to double that to take in the higher price levels and the improvements in education and health, and the environment.

There is, moreover, a peculiarity about investment in human capital. The children of educated people tend to be more easily educated, are healthier, better adjusted. Rather than an expenditure, such investments have many aspects of further investments. The health of a better educated work force preserves that reinvestment England is still deriving dividends from what money it spent on Shakespeare's or Newton's education. Both in coin and in improved living conditions, and creative inspirations.

Why then is there such hesitation for resorting to the solution that has been under our noses since this crisis began?

W. Krehm

They Know Not What They are Talking About in the Most Literal Sense

The New York Times (31/01, "Economic Dive Deepens, giving Stimulus Urgency" by Louis Uchitelle) reports: "The economy shrank at an accelerating pace late last year, the government reported on Friday, adding to the urgency of a stimulus package of bringing the country a recession that appears to be deepening.

"The actual decline in the Gross Domestic Product – at a 3.8% annual rate – fell short of the 5 to 6% that most economists had expected for the fourth quarter. But that was because consumption collapsed so quickly that goods piled up in inventory, unsold but counted as part of the nation's output.

"The dismal fourth quarter, and the likelihood of more of the same through the spring, are fueling discussion among policy makers and politicians over the best way to spend the soon-to-be authorized federal money.

"Some caution that President Obama's proposals try to achieve too many objectives – for example, broader health care coverage and energy efficiency – at the expense of focusing the dollars on the core issue of job creation. By this argument more should be spent on things like infrastructure repair, either directly or by channeling money to the states or projects now delayed for lack of adequate tax revenue.

"The president took a different approach in a press conference on Friday. Seizing on the damaging fourth-quarter figures and the prospect of an even weaker first quarter, he called the contraction a 'continuing disaster' for working families and pushed Congress to act quickly to provide relief.

"Even with the help of swelling inventories, the 3.5% contraction, adjusted for inflation and representing all the nation's economic activity, was the largest economic drop in output since the 1982 recession.

"Business investment, commercial construction, home building and exports all fell steeply, most of them doing so for the first time since the recession began 13 months ago. Data released this week suggest the decline had continued. As for consumer spending, in only one other quarter since records were first kept in 1947 have final goods and services sales produced in America fallen as much.

"Christina D. Romer, chair-woman of the president's Council of Economic Advisers, said in a statement that 'aggressive, well-designed fiscal stimulus is critical to reversing this severe decline.' She did not describe the elements of a well-designed fiscal stimulus. but the vast majority of the nation's economists agree that one is necessary, and soon."

Yet, "Virtually none dispute that the usual route to recovery has failed to work this time – not when lenders are pulling back, despite prodding from the Federal Reserve, and borrowers are focused more on paying down debt and building up savings.

"'I'm hoping the fiscal stimulus will be a catalyst to reignite the private sector,' said Stuart Hoffman, chief economist at the PNCC Bank Corporation in Pittsburgh. 'My hope is that as the fiscal stimulus kicks in, people will begin to spend and invest more, modestly anyway, in the second half of the year.'"

We are Missing the Most Relevant Cut of History

"Absent a large stimulus package, most economists expect the nation's output to shrink, not only in the first half of the year, but in the second as well. In April, the recession would become the longest since the 1930s. This one began in December 2007 as employment peaked and began to fall. Until now, the record, 16 months, was shared by the severe recessions of 1974-5 and 1981-2. This one began in December 2007 as employment peaked and began to fall.

"The Federal Reserve ended the mid-70s and early '80s recessions by cutting interest rates sharply to encourage borrowing and spending in the private sector."

That is a bit of very curtailed history. And the piece of history missing is precisely what we need to understand – a completely paid-up capital resource we have that would enable us to spend with a clear conscience, were we allowed to know the full import of that bit of suppressed history.

But let me put the whole matter of what passes for economics in proper perspective.

It arose in the 17th century and especially with Adam Smith, before the great industrial revolution based upon Watt's steam engine had begun. What Smith and his peers considered industry was essentially based not on non-human energy, but on the division of labour. The working class was illiterate, and this allowed the philosophers who dealt with economics to speak their minds and start out with labour to explain how it turned up as the key factor in most economic problems. Adam Smith, for example, had three distinct versions of the labour theory of value – the determinant of market value, cost of production version – representing the accounts the mill-owner had to look after to keep his business going, and finally the labour commanded – the amount of labour it could buy – a most relevant version of the labour theory today, important in our relations with China and for sorting out the entire world economy mess. But once – thanks to philanthropic mechanics institutes after the Napoleonic Wars, factory workers started learning to read and even write. It ceased being politically sound to refer to labour as the source of all value. Particularly since in 1848 barricades were thrown up across Europe. Even more so after the fall of Paris, and the Commune. The locale of value creation and determination was accordingly shifted from the factories to the elegant shopping markets of London and Paris, where it was taken as determined by the amount of enjoyment it inspired in those who bought the goods. It was in a deeper sense a heroic search after a substitute for at least a remnant of the illiteracy that employers had profited from amongst their labourers. Not by accident marginal utility value theory rose almost at the same time in three different capitals – London, Paris and Vienna. Unemployment was denied to exist, with the explanation that the unemployed worker had merely decided that leisure in his parlour would enhance his *joie de vie,* more than working for the wage offered.

To a considerable extent economics today remains an attempt to replace the lost innocence of the workers in the 18th and early 19th century – the illiteracy of the workers of that day.

That can even be generalized to include the mathematics of derivatives. Though formally it deals with calculus, it is so contrary to the spirit and the least serious knowledge of what mathematics cannot do that it is a subject of amusement amongst mathematicians.

That, too, like most mathematics used by economists must be considered a case of nostalgia for the days when workers were illiterate and there was no reason for serious economists not to speak their mind.

But the abrogated privileges come at a huge cost to society. The present seemingly irreversible economic collapse is a supreme example of the phenomenon.

If economists were not so shut and bolted to any relatively new idea there would have been no ever deepening collapse of the world today.

For what prevented a major world economic collapse was avoided in a very simple way in 1996. When faced with an incipient meltdown of the economy due to the ravagings of deregulated banking, the Clinton government for the first time brought accrual accountancy into the government ledgers. Whereas prior to that when the government made a physical investment, they automatically set it up in their books in a bizarre way. That which was built or bought was completely written off *(depreciated)* in a single year while the money spent for the asset-acquisition was likewise *amortized* over its probably useful life and was entered on the other side.

This had an immense double usefulness for those in the saddle. It resulted in major deficits in the government that were not really there, but served usefully to keep wages low, and was immensely useful in arranging some highly lucrative privatizations for the well-connected.

Clinton Brought In Serious Accountancy for Physical Government Investments

However, in 1992 this resulted in deepening crisis. In desperation the Clinton government actually brought in accrual accountancy, which – carried back to 1959 – brought on to the books well over one trillion dollars of prepaid physical investments that had been kept assiduously off those books.

That brought Clinton a second term and carried on a boom that extended right until the crash of 1998.

That is rarely if ever mentioned even in newspapers of the category of *The New York Times.* The immediate cost of that suppression you can read in laments such as the one we are discussing. But a single article in the *Times* or other newspaper of similar caliber would point out that treated like current assets rather than as investments, perhaps twice the amount as did the job with brilliance in cutting off the depression that had shown every sign of beginning in 1991. (Hallelujah – it has happened! See "Our Hats Off to The New York Times…" on page 6.)

I write "perhaps twice as much" because not only have prices risen and the economy

From Iceland to Persian Gulf, the Bank Chill Moves to Freeze

The Wall Street Journal (27/01) supports the one-world model in some highly unforeseen ways. "Iceland's Leadership Collapses as Ire over Crisis Intensifies" by Charles Forelle reports a political disaster: "Iceland's government collapsed on Monday, days after its prime minister called for early elections amid popular anger over a popular anger over a financial crisis that has gutted the economy.

"Prime Minister Geir Haarde said he and his cabinet would resign immediately. The move came after his Independence Party failed to come to terms with the Social Democrats, its main partner in Iceland's coalition government. On Monday afternoon, Mr. Haarde presented his resignation to Iceland's president.

"Mr. Haarde was working to form a new government, his spokesman said, but Social Democrat leaders were demanding a fresh face. 'The government's actions in the last few weeks have been and months were not swift enough,' Foreign Minister Ingibjorg Solrun Gisladottir, the leader of the Social Democrats, said on Monday, according to Agence France-Presse.

"It is far from clear who will run Iceland until elections scheduled for May. Ms. Gisladottir proposed a fellow Social Democrat, Johanna Sigurdardottir, but Mr. Haarde's spokesman said the Independence Party – which had a plurality of seats in parliament – is determined not to hand over the prime minister's office.

"That could open the door for the Independence Party's second-in-command, Thorgedur Katrin Gunnarsdottir, currently educational minister. Iceland's president, who hold a largely ceremonial post, has authority to designate as person responsible for forming a government.

"Iceland becomes the second European nation – after Belgium – to lose its government in the global economic crisis. Iceland may be the world's hardest hit. Last fall, three big banks, or virtually the entire banking system, collapsed, and the island's currency went into free fall.

"The currency and banking crises have caused a swift reversal of fortune for Icelanders, per capita once one of the world's wealthiest peoples. Today inflation and unemployment are soaring, debt is mounting and the banking sector that provided jobs and fueled a consumption boom has vanished. Anger at Iceland's leaders has been palpable for months. Since the fall, raucous demonstrations in front of the parliament have drawn crowds of thousands. Protesters have pelted the building with eggs and rolls of toilet paper, and displayed effigies of Mr. Haarde.

"Until last week Mr. Haarde was defiant, saying Iceland – which has accepted a $2.1 billion bailout from the International Monetary Fund – couldn't afford political chaos as it tries to rebuild its economy.

"But on Friday, he said his doctor had discovered a tumor of the esophagus, and that he would call for early elections in May and stand down as the party's chief.

"Leaders of the protests said that wasn't enough. Demonstrations continued throughout the weekend. By Monday, the coalition had broken and Mr. Haarde faced open criticism from his partners.

"At the root of Iceland's troubles was an outsize banking system, which grew wildly overseas and built up foreign liabilities many times the size of Iceland's economic output. When the credit crunch struck, the banks faced difficulty making payments, and Iceland's central bank didn't have the foreign currency to bail them out."

We have then on a miniature gigantic scale the financial elevators of our homeland with storey upon storey of money creation through the banking multiplier resulting in elevators that accelerates moving ever upward, only to crash when it goes too high and too fast.

W.K.

expanded, but because the investment in human capital was proven by an initiative of the US government itself at the end of WWII. At that time hundreds of economists were sent by Washington to Germany and Japan to study the war damage and foretell how long it would be before these two countries could rebuild their countries to become the formidable competitors on world market that they had been.

In 1961, one of these economists, Theodore Schultz wrote that it was astounding how wide off the mark they had been. This he explained by their having concentrated on the physical damage and overlooked that the human capital, disciplined, educated talented, had come through the war practically intact. From this he concluded that human capital is the most profitable investment a government can make – the concept enlarged to include the environment, social

Our Hats Off to The New York Times, Urofsky, and the Need for History and Sociology

Have you been sifting the resources of sociology, the discipline of how we do our thinking on matters that concern society as a whole? The dilemma: that in turn requires information, and that in turn requires nurturing and indeed designing our thinkers which brings in our universities, and government funding, and these are moving on legs bucking under them financially from hips to toes. Even the most illustrious, which would include the *Times* very near the top, are having their troubles, with the common stock bought by business magnates and only special shares held by the original family founders. And advertising revenue continues downhill, from the position as special shares looking after the reputation of the papers. That is every further input of vital input – even on the past history of depressions and banking and how the US and the world eventually found their way out of the Depression, is something that has to be pumped up in the midst of failing finance arrangements. That is why our hats off to *The Times* for restoring to us a further cut of our crucial history (07/02, "The Value of 'Other People's Money'" by Melvin I. Urofsky). In fact it merited a subheadline, "The Value of our History."

"Gaithersburg, MD – Some things never change. When President Obama spoke last week of 'shameful' bonuses for bankers and the financial community's 'irresponsibility' he echoed charges leveled nearly a century ago by Louis D. Brandeis. Brandeis, a commercial lawyer, leading reformer and future Supreme Court Justice, described a dangerous combination in *Other People's Money and How the Bankers Use It*, one of the best-known exposes of the Progressive era.

"Published in 1914, the book was based on the revelations of the House of Representatives' Pujo Committee about the predatory practices of J.P. Morgan and other big bankers. *Other People's Money* influenced both Woodrow Wilson's New Freedom agenda and Franklin Roosevelt's New Deal. It also offers valuable lessons for today.

"Our current crisis, after all, was in part fueled by bankers making big gambles with other people's cash. They bundled and sold sub-prime mortgages, took their profits, and then left others holding portfolios full of worthless, even toxic, paper. That was exactly the kind of behavior Brandeis despised. He believed it was one thing for an individual to put up capital in risky adventures, playing to win but prepared for failure. But he saw the bankers of his time dodging failure by manipulating the marketplace at the expense of small entrepreneurs and consumers.

"As president, Wilson tried to put a stop to this. He read the book and called Brandeis in to help draft three bills crucial to the New Freedom agenda – the *Federal Reserve Act*, the *Clayton Antitrust Act*, and the law establishing the Federal Trade Commission. These measures allowed Congress to take away banks' control over currency, banned interlocking directorates (in which banker representatives controlled other corporations) and established rules of fair competition.

"Banks found it relatively easy to get around these rules in the 1920s, especially with Republican administrations that did not seem to believe in market regulation. Bankers promoted the purchase of stock on low margins or down payments, often as little as 10% of the price, and then financed the difference by loans, while their brokerage divisions sold the stocks. Then the stock market collapsed in the fall of 1929, taking the banking system down with it.

"During the Great Depression, people turned to Brandeis once again. *Other People's Money* was reissued in an inexpensive edition, and many of those who came to Washington to work on Franklin Roosevelt's New Deal read it. The New Deal Laws, particularly the *Glass-Steagall* and the *Securities Exchange Acts*, imposed long overdue regulation of the banking system, required the separation of banking from stock brokerage, and established the Securities and Exchange Commission to regulate the stock markets.

"For Brandeis, regulation was not supposed to be a restraint on renovation or the entrepreneurial spirit, but rather a check on unbridled greed. He believed in a free market, but one in which the government enforced rules of fair competition so that the most talented could succeed. Clear rule would help ensure that business was conducted fairly and openly.

"*Other People's Money* can help us navigate the new era of regulation that we are likely to enter. It would be wise for Mr. Obama to heed Mr. Brandeis's advice before imposing stricter rules on banking and the stock market. For these plans to be effective, Brandeis would caution, they must be more than cosmetic. Government should oppose banks' purchases of stock brokerages, for example, to avoid the problems that Brandeis exposed. Furthermore, new rules won't accomplish much without effective watchdog agencies. The Securities and Exchange Commission, for example, seems to have abandoned its oversight responsibilities during the Bush years, and now we are paying the price.

"As we reel from the financial crisis, *Other People's Money* and similar indictments of immoral banking behavior will likely find a new audience. Some of the trouble-making bankers will, perhaps, be temporarily chastened. But before we know it, they will once again be complaining about regulation's 'interference' with the market. Don't listen to them. Good regulation will keep us from losing sight of the importance of those same principles that Brandeis emphasized so many years ago – honesty, openness and a fair playing field."

W.K.

Melvin I. Urofsky is a professor at Virginia Commonwealth University and the author of the forthcoming *Louis D. Brandeis: A Life.*

well-being, health. For this he was feted, decorated and after a very few years completely forgotten except by a few stubborn principled folk like those in COMER.

The important point is that although even our money since 1970 appears as debt, it is in fact a very positive thing. That was accepted under duress in the case of physical investment in 1996, It is not even granted a mention when COMER estimated perhaps twice the amount of prepaid human capital in exactly the same position as physical capital of the government had been in 1993.

There are a few special oddities that enhance the value of human capital. The children of educated parents are more readily educated – much of the education takes place at home, genes make their contribution. In a sense every expenditure of that prepaid investment turns out an investment itself.

Whatever the English government spent on the education of Isaac Newton has come back to it many times and continues so long as there is a Britain. In a way coming down to more modest rates and levels that extends to all investment of human capital.

It would be enough to recognize the neglected prepaid human investment, spend (or *reinvest* if you wish) it, and there would be no reason whatever playing the games that governments find it necessarily to play across the world, certainly in the larger, modern countries where such human prepaid human capital investment abounds. Make use of it, and you will have no crisis – any more than you did in the US in 1996.

Stop trying to imitate illiteracy of Adam Smith's labouring classes, waving degrees in economics as supposed justification for the scam.

William Krehm

Humanity Bundled, Sliced and Diced

President-elect Obama promises more than an innovator to become a missionary spreading a new embracing gospel to other branches of humanity.

The New York Times (16/1, "Japan's Outcasts Still Wait for Society's Embrace" by Norimitsu Onishi) reports: "Kyoto, Japan – For Japan, the crowning of Hiromu Nonaka as its top leader would have been as significant as America's election of its first black president.

"Despite being the descendant of a feudal class of outcast, who are known as burakus and still face discrimination, Mr. Nonaka had dexterously occupied top posts in Japan's government, and served as the government's No. 2 official. The next logical step was to become prime minister. Allies urged him on.

"But not everyone inside the party was ready for a leader of buraku origin. At least one, Taro Aso, Japan's current PM, made his views clear to his closest associates in a closed-door meeting in 2001.

"'Are we really going to let those people take over the leadership of Japan?' Mr. Aso asked according to Hiaoki Kamei, a politician who attended the meeting.

"Mr. Kamei said he remembered thinking at the time that 'it was inappropriate to say such a thing.' But he and the others in the room let the matter drop, adding, 'we never imagined the remark would leak outside.'

"But it did – spreading rapidly among the nation's political and buraku circles. And more recently, as Mr. Aso became PM just weeks before President-elect Barack Obama's victory, the comment has become a touchstone for many buraku.

"How far have they come since Japan began carrying out affirmative action policies for the buraku four generations ago, mirroring the American civil rights movement? The topic remains Japan's biggest taboo, rarely entering private conversations and virtually ignored by the media.

"The buraku – ethnically indistinguishable from other Japanese who, according to Buddhist beliefs, performed tasks considered unclean. Slaughterers, undertakers, they were called *eta* which means defiled mass; or *hinin*, nonhuman. Forced to wear telltale clothing, they were segregated in their own neighborhoods.

"The oldest buraku neighborhoods are believed to be in Kyoto, the ancient capital, and date back a millennium. That these neighborhoods survive to this day and that the outcasts' descendants are still subject to prejudice speak to Japan's obsession with its past.

"In Japan, every person has a family register kept in the local town halls and that, with some extrapolation, reveals ancestral birthplaces. Families and companies widely check birthplaces to ferret out buraku among potential hires or marriage partners until a generation ago, though the practice has greatly declined, especially among the young.

"The buraku were officially liberated in 1871, just a few years after the 13th Amendment abolished slavery in the US. But as the burakus' living and educational standards were far below national levels, the Japanese government, under pressure from buraku liberation groups, passed a special measures law to improve conditions for the buraku in 1969. By the time the law expired in 2002, Japan had reportedly spent about $175 billion on affirmative action for the buraku."

Specially Sashed Equality

"Fumie Tanaka, now 39, was born just as the special measures law for the burakus went into effect. She grew up in the Nishinari ward of Osaka, in one of the 48 neighborhoods officially designated as buraku areas.

"At her school the children began learning about discrimination against the buraku early on. Instead of hiding their roots, children were encouraged to 'come out,' sometimes by wearing buraku sashes, a practice that Osaka discontinued early this decade, but that survives in the countryside.

"Ms. Tanaka encountered discrimination only when she began going to high school in another ward. One time, when she was visiting a friend's home, the grandparents invited her to stay for lunch.

"'The atmosphere was pleasant to begin with, but then they asked me where I lived,' she said, 'and when I told them, the grandfather put down his chopsticks right away and went upstairs.'

"A generation ago, most buraku married other buraku. But by the 1990s, when Ms. Tanaka met her future husband, marriage to outsiders were becoming more common…. But there are problems left.

"In Osaka's 48 buraka neighborhoods, from 10 to 1,000 householders each, welfare rates remain higher than Osaka's average. Educational attainment still lags behind, though not by the wide margin of the past.

"By contrast, Tokyo decided against designating the buraka neighborhoods. It discreetly helped buraka households, no matter where they were. The emphasis was on assimilation. In one of the oldest buraka neighborhoods, just north of central Tokyo, nothing differentiates the landscape from other middle-class areas in the city. Now new-comers outnumber the old-timers, The old-timers, however, who all know each other, live in fear that their roots will be discovered, said a 76-year-old woman who spoke on condition that neither she nor her neighborhood be identified.

"'Me, too, I belong to those who want to hide,' she said."

A Politician's Roots

"Mr. Nonaka is one of the rare politicians who never hid his buraku roots. In 2001, he was considered a leading contender to become president of the long-governing Liberal Democratic Party and prime minister.

"Now 83, he was born into a Buraku family from a village outside Tokyo. In 2001, he was considered a leading contender a leading contender to become president of the long-governing Liberal Democratic Party and prime minister.

"On his way home at the end of World War II, he considered disappearing so that he would be considered dead, he once wrote. With the evidence of his buraku

Strangled Credit

The Globe and Mail puts it all as concisely as in a thimble (15/01, "Tight credit hinders metal processors" by Allan Robinson): "One good thing manufacturers have going for them is the low cost of commodities. Come to think of it, that might be the only good thing.

"The producer price index – the producer price index – a measure of the average change in prices received by commodity producers in all stages of processing – is forecast to have declined 2% during December, compared with a 2.2% drop in November, according to a survey of economists by Bloomberg.

"'The commodity bust likely cut producer prices for the fifth straight month in December,' said Sal Guatieri, a senior economist with BMO Nesbitt Burns Inc.

"On a year-over-year basis, prices are forecast to have declined 1.1 per cent in December, compared with the 27-year high in July when prices rose 9.9%.

"Base metals have been one of the hardest hit sectors. 'Undoubtedly, metal prices will not remain at today's levels to the end of the first quarter of 2009,' according to a report by Desjardins securities.

"'If prices stay here you will see smelter closures world-wide,' according to a report by Desjardins Securities analyst, John Redstone. 'What we are seeing is a complete lack of credit financing. Even the few people who want to buy metals can't get financing.'

"'It is the frozen credit markets and unwillingness of the banks to lend to each other that has been a critical problem facing the mining industry,' Mr. Redstone said. 'We have heard reports of a truck load of molybdenum being turned around at the gate,' he said. 'Not because they didn't want it. but because they can't finance it.'

"However, there are indications that the bank credit markets are returning to some semblance of normality. The spread or difference between the three-month London interbank offered rate (Libor) and the overnight index swap (OIS) has declined to about 100 basis points – 'a return to "normalized" financial liquidity in Europe by early to mid-February,' the Desjardins analysts said. The spread reached 364 points on Oct. 10. (A basis point is 1/100 of a percentage point.)

"Libor is the interest rate at which banks lend to each other, while the OIS rate assesses the outlook investors have for the overnight interest rates. The normal spread is 25 points to 50 points. 'Once this is achieved, active buying and selling of metal and the natural flow of metal product throughout the supply chain can be reactivated,' the analysts said. 'We believe this event is required as a first step towards sustainable increases in base metal prices.'

"But the credit markets are still not healthy. 'We think that Libor/OIS could still tighten further, not to pre-crisis levels below 20 basis points, but probably to something like 50 to 75 points through the first half of 2009,' said Roger Quick, director of fixed-income research for Scotia Capital Inc., in a report to clients.

"And there is no hurry for investors to significantly add to their metals sector exposure,' Desjardins said. First, investors should wait for the release of the fourth-quarter financial results which are likely to be dismal. Secondly, the should wait for the credit markets economic results from China. 'The recently announced Chinese stimulus package should only begin affect the economy in the first quarter of 2009,' according to Desjardins."■

roots expunged, he was in a position to remake himself in another part of Japan, he wrote.

"Mr. Nonaka eventually entered politics, and, known for his fierce intelligence, he rose quickly. By 2001, he was in a position to aim for the prime ministership. But he made up his mind not to seek the post. While he had never hidden his roots, he feared that taking the top job would shine a harsh spotlight on them. Already, the increasing attention had hurt his wife, who was not from a buraku family, nor was his daughter.

"'The same happened with my son-in-law. So, in that sense, I made my family suffer considerably.'

"And so, at the closed meeting in 2001, Mr. Aso made the comment about 'those people' in a considerably loud void, recalled Mr. Kamei, the politician. Mr. Kamei, now 69, had known Mr. Aso since their elementary school days and was one of his biggest backers.

"Mr. Aso's comment would have stayed inside the room had a political reporter not been eaves-dropping at the door – a common practice in Japan. But because of the taboo surrounding the topic of the buraku, the comment was never widely reported.

"'That someone like that could rise all the way to becoming prime minister says a lot about the situation in Japan now,' said Kenichi Kadooka, 49, who is a professor of English at Ryokoku University and is from a buraku family.

"Still, Mr. Kadooka had not let his anger dim his hope for a future buraku leader of Japan."

All that is needed is the equivalent of the rubber eraser that comes with many pencils at another level of Japanese life – and now in American politicians with Mr. Obama's electoral triumph in the US.

W.K.

Sweden's Fix for Banks — Nationalize the Bad Banking Part and Clean It Out

The New York Times (23/01, "Sweden's Fix for Banks – Nationalize" by Carter Doughterty) has worked a new version of setting up for readily unsaleable assets: "In the process Sweden wiped out special 'bad banks,' if you wish, and put in charge experts in mergers and acquisitions who are likely to pick themselves bargains for well-financed clients looking for acquisitions. And, most amazing, it has worked: 'The Swedes have a simple message to the Americans.' Bite the bullet and nationalize.

"Officials in Washington are trying to figure out how to shore up American banks that once ruled the financial world, but now seem to weaken by the day, despite receiving hundreds of billions of dollars in governmental aid.

"When Sweden's banks, effectively bankrupt in the early 1990s, a center-right government pulled off a rapid recovery that led to taxpayers making money in the long run.

"Former government officials in Sweden, many of whom come from the market-oriented spectrum, say this is the only way to solve the crisis in the US is for the government to be prepared to temporarily take full ownership of the banks.

"Sweden placed its banks with troubled assets into a so-called 'bad bank,' where they could be held and sold over time when the market and economic conditions improved. In the meantime it used taxpayer money to provide enough capital to allow banks to resume normal lending.

"In the process, Sweden wiped out existing shareholders. 'By contrast, the US government, so far, has bailed out the banks without receiving large equity stakes in return,' said Bo Lundgren, Sweden's minister of fiscal and financial affairs during the Swedish bank takeover.

"'For me, that is a problem,' said Mr. Lundgren, who called himself more of a free marketer than some Republicans. 'If you go in with capital, you should have full voting rights.'

"The US has a much larger economy than Sweden's, with a vast and international banking system. The toxic assets Sweden took from its banks improved when the economy improved, but Sweden was not confronted with a global recession.

"Still, many analysts believe Stockholm has lessons for Washington.

"In effect, the Swedish state took on all the assets that were possible or impossible to value at the time, and then managed or sold them with the aim of getting as good a deal as possible for the taxpayer.

"'We hired real estate people,' said Lars H. Thunell, the former chief executive of Securum, the institution that became Sweden's repository of all Sweden's underwater assets. We hired industrial Merger and Acquisition people. We need to manage real assets.

"The United States commitments to the banks by the Treasury and the Federal Reserve, American taxpayers have in effect used mostly loans to turn themselves into emergency credit of financial system.

"For their part, bank shareholders have taken big hits as the stock plummeted, But the government has largely avoided acquiring equity and diluting the value held by the existing shareholders.

"Former Swedish officials said that was a mistake, for political reasons if nothing else, because owners of bank stocks did so well in the boom years early in the decade.

"Fears of bank diversification are diverse – skeptics worry that nationalization would cost too much, the governments would not run banks effectively or nationalization would be much too complicated. Moreover, he said the mere threat of nationalization nudged some Swedish banks to find creative solutions to their problems in the 1990s.

"SEB, the bank controlled by the Wallenbergs, the first family of Swedish business, engineered a private recapitalization to plug the hole in the balance sheet. Only Swedbank initially signed up for a bad bank of its own, freezing management to run the sound parts of the business.

"Nordbanken, as Swedish bank that had expanded in the go-go years of the late 1980s, fell entirely under the control of the government because its losses were so great. It is now Nordea, a banking giant in the Baltic Sea region.

"Securum was capitalized with 24 billion kronor ($2.88B, a sum equal to the country's military budget at the time. (The total US military budget is less than the $700 billion allocated to TARP.)

"A study by the Federal Reserve Bank of Cleveland concluded that Securum eventually returned about 58% of that upfront cost to the Swedish treasury, though in depreciated kronor.

"That does not mean that Sweden has escaped the current banking turmoil unscathed. As credit markets froze last fall, it created a financial stabilization package to ensure new lending from banks. Only Swedbank initially signed up for the plan. Other banks have moved to raise capital in the market.

"To make Securum work in the 1990s, the Swedish state had to become a specialist in such diverse industries as chemicals, biotechnology, office supplies, aerospace industry services, as would certainly be the case in the US, real estate.

"Chunks of real estate from Stockholm to London to Atlanta have been collateral for loans and occupied 70% of the portfolio of Securum.

"Securum owned the Australian Embassy building in Myanmar, as well as a guitar said to have belonged to John Lennon and a company that employed military advisers in Yemen.

"Securum hemorrhaged money in its first year in business, which was in 1993, but recovered quickly, as savvy deal-making combined with a quick pickup in the Swedish economy created markets for what was seemed to worthless. Early on, Securum sold a chemical company it controlled, Nobel Industries, to Akzo of the Netherlands, to form the largest paint producer in the world, Securum later reaped a hefty profit when it sold out.

"There is no guarantee the Obama administration will be so fortunate, with a global economy facing its most severe downturn in decades.

"If there is any criticism of how Sweden handled the bad bank, it is that it might have managed an even better return if Securum had sat on its assets longer. Swedish law envisaged a 15-year life-span when it was created in 1993. It closed four years later."

This is a particular technique far salvaging value of what the public sector had picked up a "bad bank" to be stored for careful specialized marketing by a country that knows what it is doing and can arrange its affairs to take on a special repertory of special bad assets. Illiquid key downtown sites of growing large cities or key highway corners are cases in point. The government's ability to carry such "snoring assets" will in fact depend on how it arranges its key concerns for looking after the country's key capital investments.

W.K.

RENEW TODAY!
(SEE PAGE 2)

The President-elect Approaches the Greatest of All Trials

The New York Times (09/01/09, "Easy Loans Financed Dividends" by Floyd Norris) grazes the issue, but withdraws as though he were playing with fire: "Dividends don't lie."

"Chalk up the death of another Wall Street cliché. In the late bull market, dividend payments provided one of the seemingly strongest arguments for the bulls. Maybe earnings numbers could be manipulated, but dividend payments required cash. If the company had cash to hand out, you could be confident that the earnings were real. [But that] was a lie."

For silence can be the greatest of lies – timeless and unlimited as well in all other dimensions.

How could the President-elect be doing this to himself and to his place in history? If he should fall for the official view on our bank mess, it would be like learning that Abe Lincoln cheated at poker just to keep in practice.

"It is now becoming clear that the great news on the dividend front from 2004 through 2006 was not an indication of solid corporate performance; it was just another sign of lax corporate standards. Lenders who willingly handed out money to homeowners with bad credit were even more generous to corporate borrowers.

"The quarter just ended has had the worst dividend news for American companies in half a century, and this quarter can be even worse. Many corporate boards review annual performances and decide what to do about the dividend during the first two months of each year, and it is not likely to be a happy time. Until those meetings are completed, buying stocks for their high dividend yields may be risky.

"'Investors need to be careful of overly generous yields,' said Howard Silverblatt of Standard & Poor's, pointing to the possibility that more cuts will soon be announced.

"In the final three months of 2008, S & P counted 288 announcements by American public companies of dividend reductions or eliminations, in contrast to 239 companies that either initiated or raised their pay-outs. It was the first time since 1958 that there were more negative announcements than positive ones.

"In the boom years of 2004 through 2006, there were fewer than 100 negative announcements each year – the three best years in that regard since S & P started collecting data in 1955.

"Companies appeared flush with cash those days, but some of that was a mirage stemming from optimistic accounting, particularly at banks. In other cases the cash was real but it did not stay in corporate treasuries very long. Wall Street was preaching the doctrine of shareholder value, and corporate America bought shares back at an unprecedented rate."

The "swap" production had simply been transferred to another stage and producer.

"From the fourth quarter of 2004 through the third quarter of 2008, the companies in the S & P 500 – generally the largest companies in the country – reported net earnings of $2.4 trillion. They paid $900 billion in dividends, but they also repurchased $1.7 trillion in shares."

Shareholders Rewarded for Dumping Shares

"As a group, shareholders were paid about $200 billion more than their companies earned over that four-year period. Suffering investors who held onto their shares during the 2008 plunge may want to reflect on the fact that investors who were dumping their shares got roughly twice as much of the money as loyal holders did.

"It was not only public companies that were able to pay dividends with cash that might have come from lenders rather than from profits. Private equity firms were able to bolster their returns by having companies they owned borrow more money and use the cash to pay dividends. Now some of these same companies are struggling to find cash to finance operations.

"The pain from excessive pay-outs to shareholders from years past will be amplified by the fact that corporate loans will have a lot in common with exploding mortgages that came to dominate the home mortgage market before it collapsed.

"The new mortgages ended that. Some were known as 3-27 or 2-28 mortgages with a teaser interest rate for the first two or three years, and then a sharp increase in payment no matter what happened to market rates. Others were interest-only, or called for payments of even less than the interest being accrued. The common thread was that the borrower would have to refinance at some point. Now, of course, many cannot. Their homes are not worth what is owed, or their income is not adequate to support such a loan under the tighter prevailing standards.

"In the business sector of the economy, similar loan terms were common. Many companies were financed by bank lines of credit that had to be renewed every few years. Even bond issues were only for 5 or 10 years. Most commercial real estate loans in recent years called for payments of just interest, with the entire loan to be refinanced within 10 years.

"To make things seem even better during the good years. lenders were willing to lend larger sums, assuming that rents would rise rapidly in commercial buildings, or that profits would do the same at companies. Where that did not happen – that is in most places – many loans will not be able to be rolled over when they mature. Unnecessary bankruptcies loom.

"So did dividends lie? Perhaps they were simply misunderstood. Their real message from 2004 through 2006 was not that corporate America was not doing so well. It was that lenders had embarked on an unsustainable credit expansion that was sure to end in tears."

But are there not ways to sop up those tears?

There happens to be, tested and found brilliantly successful in finally coping under the Great Depression of the 1930s. And President Obama's record in applying those proven lessons of history will call for more than choosing as counsellors people knowledgeable about the habits and the habitués of the power corridors of the land. For obviously they have failed us, or we would not be faced with the present stubborn meltdown of the economy. That collapse has two profound contributing factors. One has been the gelding of economic theory where it has over the past half century come to focus on the interests of ever more speculative and globalized banking. To achieve this, economic theory has been repeatedly revised to adjust to the working class learning to read, and hence becoming able to follow the discussions of economic theory, which had been beyond the ability of their illiterate forebears. This made the labour theory of value – to Marx's delight it had been brought by stock-broker David Ricardo to depend on the amount of "average labour" entered into the production of a commodity. Adam Smith preceded the industrial revolution – in the workshops of his day it was the division of tasks into their most simplified stages that was the greatest source of profits.

Adam Smith's Three Different Value Theories

Adam Smith actually used three different theories of value depending upon what aspect of production he was seeking to understand. For a general overview of production, he used an equivalent of Marx's "average labour." When he was dealing with the specific problem of the employer in paying his bills as they came in, he used a cost of production theory. And finally – an approach that has become keenly important to our understanding of what goes on in China today – the amount of *commanded labour* a given batch of products will buy.

All variants of the importance of labour as determinant of value were acceptable to the capitalist so long as the workers were illiterate. The discussions of the masters on such matters was not unlike the gossip of parents about intimate scandals of friends and neighbors once the children had been put to bed. But suddenly workers were learning to read through the efforts of mechanics institutes.

This emphasis on labour in one form or another as the major contributor to value creation, was potentially seditious when barricades of class struggle were being thrown up throughout the continent. Hardly surprising then that marginal value theory to fill the great need for it should have arisen independently almost at the same time – Britain Austria and France. Value was reduced to the amount of enjoyment the consumption of a given product gave the consumer. That different observation perch had a newly reassuring explanation of mass unemployment. It was just that the workers derived greater pleasure from leisure in their parlor than going into the mill at the wage offered. Why then should the authorities – or trade unions – for that matter – interfere with the pleasures of worker and capitalist alike?

With deregulation and globalization the push toward ever more rapid growth quickened with the illusion that infinitesimal calculus gave the practitioners the skills and foresight to track the future rates of growth in unbounded degree.

The late great French economist, François Perroux formulated a theory of a *dominant revenue* whose return on investments comes to be as an index of the welfare of society as a whole. Under the large landlords in post – Napoleonic times it was the land rent of the large landlords in Britain, protected by high tariffs against imports of food. Then it became the industrial capitalist enjoying free trade since it brought down or kept down wages of his employees. For the past four or five decades it has become the profits of speculative bankers.

That made the use of differential calculus – a tool of imperial appeal with little understanding amongst economists of what mathematics is about. Nothing can be deduced from the empirical content of mathematics – for it has none. But it is a magically powerful tool for analyzing data brought in from the outside non-mathematical world.'

Far more crucial than that will be an intimate familiarity with the crucial bits of legislation that helped get the country out of the Great Depression and the legislation – in Canada still on our law books but utterly ignored.

Roosevelt's Anti-depression Cunning

By the time President F.D. Roosevelt was inaugurated for his first term (January 1933), 9,000 US banks had already shut their doors, and the new president declared

So Soon for Obama Starting to Fray?

It is one thing for COMER to try educating Washington to three millennia and more of Afghan invasions, or bringing in sociologists to help circumvent the pre-Rooseveltian notions on how to fight off or avoid a Depression.

But when *The New York Times* (25/01, "Obama's War – Fearing Another Quagmire") resorts to quoting Rudyard Kipling to the President, is it not time for him to start re-examining if not his principles, then his chosen guides?

"When you're wounded and left on Afghanistan's plains
And the women come out to cut up what remains
Just roll to your rifle and blow out your brains
And go to your Gawd like a soldier"
Rudyard Kipling, "The Young British Soldier," 1892

a moratorium for all banks in the land that lasted a whole month. Shortly after they reopened, Roosevelt had consulted with just about anyone who had a view of what was needed to save the banking system, and brought in the *Glass-Steagall* legislation that forbade the banks from acquiring interests in the non-banking "financial pillars" – stock brokerage, insurance and mortgages. Reason: each of these has a cash and near-cash (i.e., interest-bearing) reserves for the needs of its own business. Allow the banks access to these and they will use them as legal tender base for their own bank-money creation, and thus continue multiplication of the "bank multiplier" – the multiple of bank loans to their cash reserves. The *Glass-Steagall* legislation fell into disuse and was finally repealed in the late 1990s.

To bail the banks out from their disastrous acquisitions of Savings and Loan institutions (essentially mortgage trusts) they were allowed in 1998 to load up with government debt of developed countries with no down payment. Shortly after that the Bank for International Settlements – a sort of war-room based in Switzerland that guided the banks comeback to the freedoms of the 1920s that brought on the world depression and the Second World War. Now the same BIS raised interest rates into the skies to get rid of what it chose to consider inflation. It is true when there is too much demand and not enough supply price levels will climb. but propositions cannot simply be turned around and considered still valid. If I hold a loaded pistol to my head and pull the trigger I most certainly will fall dead. But the converse is not necessarily true. If I fall dead it does not mean that I have shot myself. I may have fallen victim to a bad heart. If I move from a town of say 20,000 to New York, I am not idiot enough to expect my living costs to stay the same. How then can "officially sanctioned" economists assume that it does when much of humanity is making just a move?

A Simple Remedy — Serious Accountancy

By using derivatives in what are known as "swaps" – bets offered by insurance companies against losses of banks from losses sustained from the subprime mortgages they hold, the gamble with swaps has reached levels 50 times as high as all the mortgage investments of banks. What we are witnessing is overblown casinos disguised as banks taking over the economy.

But the most scandalous aspect of all is the fact that a simple remedy exists, that involves bringing in basic double-entry bookkeeping that the Crusaders brought back from Muslim lands almost a thousand years ago. No corporation or individual tax-payer would be allowed to get away with the sort of "cash accounting" that the government practiced in its own books until 1996 in the US and until 2002 in Canada. This, known as "cash accountancy," carefully notes the gradual "amortization" of the capital debt or the government's own outlay over the likely useful life of the capital investment financed. But the asset itself was depreciated in a single year. This practice had a disastrous effect on the government's credit position. For in year two the asset value of the physical investment would show a nominal value of a single dollar, while the debt or government capital put into the investment would be carried at it its real value, thus showing a huge debt position which was not there. Then again with valuable government assets carried beginning with year 2 at a nominal one dollar, it opened up marvelous possibilities for privatizations by well-connected speculators.

When the government of the US set up the North American Free Trade Agreement, Mexico's currency as a result dropped by some 40%. To avert disaster Washington quickly brought in accrual accountancy, and carrying back the change to 1959 retrieved asset values of well over $1 trillion. And that was over 12 years ago.

However, still left to be done is to recognize both the American and the Canada unrecognized investments in human capital.

Human capital came to be recognized as the most productive investment that a government can make as one of the greatest positive lessons to come out of World War II. At the end of the conflict Washington sent hundreds of economists into Japan and Germany to predict how long it would be before those two countries could resume their roles as formidable competitors on world markets. In 1961, one of these economists, Theodore Schultz of Chicago University, penned a startling conclusion: "We were so wide of the mark, because we concentrated on the physical destruction and overlooked that these countries had come through the war with their human investment essentially intact." From this he concluded that investment in human capital is the most profitable investment a government can make. For that conclusion Schultz was decorated with a Bank of Sweden award, invited to Canada by the then

Depression Clichés are Crowding in Around Us

Banks would seem inclined to sit on the cash funding coming in from the central government. That is not how the authorities envisaged what would happen.

The New York Times (21/10, "One Day Doesn't Make a Trend" by Andrew Ross Sorkin) tells a tale of money in the thirties being so scarce that banks tended to prefer sitting on it, whereas the ordinary businessman was too intimidated to even try borrowing the precious stuff: "The banks aren't lending. And despite what you have heard, they probably won't start yet.

"The stock market may be a way out on expectations of a credit thaw on Wall Street – and there has already been a minor one – but don't hold your breath on Main Street. The dirty little secret of the government's $250 billion handout to nine banks to get them lending again is this: So far they have it under their mattress like the rest of us.

"Need a mortgage? An auto loan? If you are in business or a consumer, it's almost as hard this week as it was last.

"Libor rates, the price at which banks lend to each other, have crept down in recent days, greasing the wheels of capitalism, or at least what is left of it.

"Some banks, like J.P. Morgan, Chase and Citigroup, actually made loans to banks in Europe on Friday. These loans are important steps on the way to recovery.

"But make no mistake, the banks are doing the opposite of what Henry M. Paulson Jr., Treasury secretary, sought when he virtually demanded that they accept the taxpayers' money.

"They are hoarding it – a bit like the government's sending out tax rebate checks and the customers immediately running out and spending it."

But with the slightest error in foretelling when the happy prognosis is scheduled to arrive, the spender can go broke. The Depression of the 1930s really said good-bye to the world after World War II had raged for a year or two.

W.K.

head of the Bank of Canada Louis Rasminsky, but soon forgotten. Few organizations other than COMER remember Schultz's feat or the important lesson involved.

We would only note that not only what is involved is a prepaid investment at least in the amount of $150 billion in Canada, and well over a $1.5 trillion in the US. However there are some amazing features of investment in human capital, especially in highly educated countries like the US and Canada. The children of educated parents tend to be more easily educated, healthier and better adjusted than the children of poor parents. That means that the recognition of this investment in human capital is itself an investment. Come to think of it, England is still reaping returns from whatever the English government's investment in educating the young Isaac Newton. And the unrecognized cash of prepaid investment funds are glowing investments even while being spent.

It is amazing that neither the US nor Canada has awakened to this bonanza prepaid lies awaiting to apply to cut off to remedy the deepening depression. There is, however, an important rider that should go with any bailout of banks from their losses. That condition is that the rescued bank should surrender one of its areas of investment in non-banking "financial pillars" – either Stock brokerage, insurance, or mortgages or credit cards so that the *Glass-Steagall* restrictions on banks would gradually be restored, gently but firmly.

President-elect Obama must not miss this heaven-sent solution, *and bring the world into an ocean of grief instead.*

William Krehm

Bringing in the Sociologist to Help Clear Up the Economic Mess

In the lengthening line of sociologists who arose to take a more questioning view of what economists thought they were doing, Emile Durkheim (1858-1917) whom we mentioned in our last issue takes a very front seat. Today we shall be dealing with a later one, Vilfredo Pareto. They shared a common view that economists were not simply re-arranging the dominant thought patterns of some venerable philosopher, whether in Hegel's own version, or Karl Marx's, who in a sense had stood Hegel's views on their heads so that they virtually ruled the universe.

Though the sociologists were highly critical of Marx's Hegelian inspirations, most of them include Karl Marx among their own – so closely did he tie his views of the world with what went on in it. Undoubtedly this was because the realism of Karl Marx not only did abandon his Hegelian inspiration, but was very much under the spell of the new technology that was taking over. He grew up in the railway-building age and without realizing what was happening he had traded in his beloved Hegel for a model that laid out society's future as railway companies do a railway. The stations were set out at predetermined intervals, and the line finally arrived at the end with everybody getting off with a beatic smile on their faces. Nothing was left to cover the enormous resulting marshlands where tracks and stations might vanish overnight as in Russia.

Emile Durkheim, you might remember, uttered the phrase, "You must choose between God and Society." On hearing such a phrase, Pareto might have begun by smiling and recalling that he had explained in his "Treatise of General Sociology" that derivations change rapidly, but their "residues" are relatively constant. In Pareto's vocabulary, residues are the sentiments or the expressions of the sentiments written into human nature and "derivations" are the intellectual systems under which individuals camouflage their passions or give a rational appearance to propositions or lines of conduct that are really not rational at all. Man is, in fact, an unreasonable being, and if in fact he rarely behaves in a logical manner, he always wishes to have his fellows take him for a reasonable fellow.

At this point you must not jump out of your seats shouting, "but this is just what economic theory needed to uncover the swindles of economics." Remain seated and continue listening.

The formula "God or Society" would have seemed senseless to Pareto. Nobody has seen God. Therefore, if you want to be a scientist, you must brush off such notions that elide, by their very definition, the sole procedures permitted scientists: observation and reasoning. And as for the concept of Society, it is a very confused concept. What reality does Durkheim propose designing when he speaks of "society," a course, a university, a country, humanity as a whole?

The Non-logical Action and Science

Understanding the Paretian system demands a rigorous interpretation of concepts of logical and non-logical activity.

"To grasp what is a logical action, it is enough to observe the conduct of an engineer or a speculator. When the economist is not deluded by the extent of his knowledge, he is able to grasp certain aspects of human conduct. But sociologists have to deal with folk that resemble neither engineers nor informed speculators.

"The conduct of the speculator, the very prototype of the economic type, has similar characteristics. He establishes a relationship with the means at his disposal and the goal he has set himself: increasing his capital. The case of the speculator is certainly not as pure as that of the engineer. There is a certain temporary spacing between the envisaged tie between the speculator's expectations and the effective relationship in real life. But assuming that the speculator's expectations were ultimately confirmed.

"We must distinguish between given actions having an objectively logical purpose and a purely subjective one. If they prove negatively related to the desired goal – either in reality or simply in our conscience – this double-negative classification is rare because humans are reasoning animals. No matter how irrelevant his acts may be to the desired goal, he tries attributing such a goal to them. That in no way helps simplify matters.

"The contradiction becomes striking with Durkheim writing that if sociology did not contribute to improve society, it would not be worth an hour of effort. In Pareto's eyes, a proposition of this sort confuses the scientific objective, which is simply *truth*, and the object of social action that is simply *usefulness*, without *there being a necessary coincidence between the two goals.*

"Many scholars and pseudo-scholars have asked unceasingly what progress might be true socialism, or authentic equality.

"The concept of experimental science that Pareto advances reduces most grandly the ambitions of sociology, and transfers us into a *world* where the formula 'society or divinity, we must choose' cannot be the result, but the object of science. In fact it would be the result if the non-logical steering involved were fully noted. This aspect of Pareto's work – who, moreover, enjoyed making his colleagues and competitors appear ridiculous, explains his unpopularity among his colleagues – even after his death in 1923."

The entire subject is so immensely relevant to the current effort of governments to restore liquidity to the private sector, that we feel that we must provide our readers with a condensed version of the distinction that Pareto makes.

This is to be found on page 423 of the book of Raymond Aron, *Les étapes de la pensée sociologique – Montesquieu, Comte, Marx, Tocqueville, Durkheim, Pareto, Weber* (Gallimard, 1967). It is a simple right-angled triangle, with the right-angle at the lower left corner and the minor angles at C and B.

To study logically the non-logical "steering" of the basic argument, we have only the observation of the acts whether B or C that often are developed as moral, religious or of other sort creep into an argument where they should have no place. The psychic state of the actors – at A – eludes our direct experience. The problem consequently assumes the following form: how can we explain C and B, if we cannot grasp directly A, i.e., the state of the spirit?

"The prominent tendency that people have of mistaking non-logical measures for logical ones leads them to believe that B is an effect of the C 'cause.' In this way a direct CB relationship is established, in place of the indirect relations arising from the two relationships AB and AC. Sometimes the relationship CB may really exist, but that does not happen as often as is generally believed. The same sentiment that induces people to avoid action B, induces them to create a theory C (relation AC). On such, say a horror at the very notion of homicide B induces them to avoid that. They will say that the gods punish homicide. But that is a C theory. (*Traite de sociologie générale, #162)*

"The tendency is for our interpreters to account for the course of the argument by the theories invoked, to explain B by C, However, in doing so they succumb to the human penchant for rationalization or, to adopt the expression of Pareto, they 'logicize.' They fall victim to the reasoning instinct of people, they really believes that their arguments stem from the doctrines cited, whereas in reality all this is determined by A, i.e., the psychic state or the sentiments."

To a certain extent, the entire first part of the *Traite de sociologie générale* is an analysis of the relations between A, C and B or B, C, A. This is an indication of the Pareto contribution reduced to its essence. It will transmit to the reader how useful, such a corrective would be to get the present economic impasse out of the blind alley that the world economy has been driven into by ignoring one of the greatest lessons to come out WWII – the conclusion of Theodore Schultz that the greatest investment a government can make is in human capital. And since this has already been done in adopting accrual accountancy in the case of *physical* government investment, with spectacular results in financing the market boom in physical investment of government – in the US in 1996, and in Canada 2002, there is no leap into the unknown involved. It would bring into the government ledgers of the US probably as much as $3 billion of credit. And invested in human capital to stave off the depression that is taking over,

William Krehm

LETTER TO THE NEW YORK TIMES

Even Better Advice for President-elect Obama

Congratulations on the fine piece of Paul Krugman in your 12/01. But it just scratches the surface – in proposing that "a dollar of infrastructure spending is more effective in creating jobs than a than a dollar in tax-cuts."

Since 1996 the US has recognized government investment in physical capital as investments rather than, as happened before, just as current expenses completely depreciated in the year when made. At the same time the debt incurred to make that supposedly $1 investment was carefully "amortized" over the likely useful life of the investment. This gave rise to a net indebtedness not really there, and too often led to some sensational privatizations for the well-connected.

By bringing accrual accountancy into the government's physical investments and carried back to 1959, the Department of Commerce figures were able to retrieve well over one trillion dollars of net asset value for the federal government. In the Department of Commerce statistics, however, this appeared under the heading of "Savings" which usually implies cash or assets readily convertible into cash, which most government investments are not.

Moreover, that still left investment in human capital out in the cold. And yet one of the greatest lessons to come out of WWII was that the most productive of all possible government investments was government investment in *human* capital. At the war's end Washington sent hundreds of economists to Japan and Germany to predict how long it would take for those former mighty traders would be able to resume that role. Two decades later one of these young economists – Theodore Schultz of the University of Chicago, published a study that explained that he and his colleagues had come up with as wrong answer because they had concentrated on the physical destruction in the defeated lead-countries and ignored that their highly educated disciplined, population had come through the war largely intact. And from that he deduced that investments in human capital – which would, of course, include care for the environment at whose bosom societies wilt or thrive.

Introducing accrual (also known as "capital accountancy" would not necessarily imply that projects had to become "shovel ready." Lowering university fees drastically could be an immense and immediate contribution to our investments and our growing unemployment.

It means that the US would immediately – by introducing double-entry bookkeeping that the Templars are reported to have brought back from Saracen lands some thousand years ago would finally have reached Washington – and hence the rest of the world.

Abraham Lincoln, to end slavery found it necessary to reform the US currency – i.e., the government's accountancy. President Obama can and should do no less.

William Krehm
Editor, Economic Reform

Max Weber — A Sociologist of Many Perspectives

Max Weber and Power Politics*, written for the 15th Congress of German Sociologists, at Heidelberg. Translated from* Les étapes de la pensée sociologique *by Raymond Aron, Edition Gallimard, 1967.*

"Your assignment in a sense has challenged my conscience. If I dared employ Weber's term for it, a scientific problem, but also a political one. For we know that Weber was not only a sociologist, but a philosopher that we all admire. He was also a political thinker, and on several different occasions hoped to become a politician. But even though he did not manage to clear that threshold, he was throughout most of his life the friend and counselor of politicians, involved in daily activity in that field. I will not then be able to comment on certain ideas and positions taken by Weber without suggesting or even formulating certain opinions on German nationalism of the period.

"At other times, a Frenchman could and even should have refused such an assignment, torn between the fear of lacking tact if he expressed his views on that subject without restraint, and the fear of lacking frankness if he avoided ruffling all sensitivities. I do not, however, feel that such nationalist considerations need stand in my way today.

"Of course, Max Weber does not altogether belong to a past that we have left behind. The controversies aroused by the book of Wolfgang Mommsen, *Max Weber und die deutsche Politik*, cannot be classified as pure science. They include the meaning we ascribe to the Germany of Kaiser Wilhelm, to the First World War, the Weimar Republic, to Hitler and the Second World War. Max Weber and Power Politics will influence our appreciation of current circumstances. Against such a background, the intervention of a Frenchman might possibly seem indiscreet if three circumstances did not allay any possible objection.

"To begin with, I cannot be suspected of any hostility towards Weber, even though today I would not express myself on the subject as I did thirty years ago in my *Sociologie allemande contemporaine.* Secondly, certain of the problems formulated by Weber have become unusually timely in France. Wolfgang Mommsen was not wrong in pointing to the relationship between the Constitution of the Fifth French Republic and the constitutional ideas of Max Weber. And, finally' the European community is becoming a common experience amongst us to the point where giving thought to nationalism (and to the nationalisms of yesteryears) is an obligation for all, whether sociologists or as citizens. Because of that I will not forget the distinction Weber made between science and politics. However, that is not a distinction that Weber himself respected consistently. It helps to avoid confusing facts and values, our wishes and reality. However, it would be good not to confuse the world as it is, with what we might wish it to be, or fear that it might.

"How are we to identify power-politics in this setting? By two definitions, one narrow, the other broad, have been proposed. One can use the term power-politics as it is carried on between states, competition for power not subject to any law, tribunal or supranational authority. In this sense, all foreign policy right up to our day, has been power-politics – no matter how different the political units have been and the relations between units. Even within states politics have power as their goal. In this second sense all politics will appear to involve power to the degree that the analyst will accent power and combat.

"Whether we choose the first or the second definition, Max Weber is typical both as politician, but also as sociologist, a power politician. He belongs to the progeny of Machiavelli, and also to the contemporaries of Nietzsche. He would have dismissed the ancient question: Which is the better regime? In his view, a nation or an person without a will to power leaves the political ring. Weber has written:

"Only master nations (Herrenvolk) have a vocation to turn the wheel for developing the world. Those who lack it will run into the self-confidence of other nations. But they will ruin themselves in that experience.

"A nation that produces only good functionaries, meritorious technicians, and honest merchants, scientists and respectable office-workers given to rhetorical battles under a pseudo-monarchist, will never be a superior nation. It would be well advised to stay with its present occupations.

"The will to impotence that literary eminences preach within the land is incompatible with the 'will to power' declared to the outer world.

"If I dwell on the broad sense of Machtpolitik, it is because my report was to cover the entire scope of Weber's sociology of politics. However, Weber, the sociologist, has written little on the struggle between governments, nations and empires. Had the time been granted him, he would have enriched such a chapter with his exceptional knowledge of history. But one detail is beyond question: Weber's nationalism predates his sociological researches. He developed those ideas living at the very heart of Kaiser Wilhelm's Germany, and absorbed these without deep reflection.

"He had decided that, the god (or demon) he would devote himself to would be the grandeur of the German nation. I advisedly employ the term 'grandeur,' though Weber was given to using 'power' rather than 'grandeur.' My reason for doing so is that Max Weber always suggests a link between power and culture. *Power* is certainly the goal, but Weber is always aware of Germany's role as a *Kulturvolk.* Power is a goal, but a condition for it is the spread of a superior culture.

"It is not the Danes, the Swiss, the Dutch or the Norwegians will be blamed if the world power – the civilization to come – is abandoned to the regulations of Russian functionaries or to the conventions of Anglo-Saxon *society* along with a sprinkling of Latin 'reason.' We will be held responsible for that. And for good reason…. (*Politische Schriften,* p. 47)."

Max Weber accepted without hesitation or demonstration the double solidarity of culture and nation. "In our days, every culture is subordinated to the national phenomenon, and all the more so as the means available to the spread of culture become more 'democratic,' both with respect to their spread and their nature.

"He wrote: 'Cultural prestige and power are tightly linked. Every victorious war favors the cultural prestige of the victor nation (examples: Germany and Japan). Whether this interdependence is favorable to the spread of culture, is another question that cannot be answered on the basis of axiological neutrality – even if we were to take account of the indices available. Art and literature of a purely German character did not surge from the political centre of Germany.' Thus it was Vienna, capital of an empire of many races and cultures that was the sources of much of Germany's great music.

"Two remarks on this text: a history

claiming to be judgment-free to the point of not passing an opinion on the quality would seem strangely impoverished. The spread rather than the quality of the culture (or more remarkable 'the prestige' seems to have been Weber's main goal).

"The originality of Weber does not consist of his clinging to this nationalism – pretty common-place at the end of the 19th century – or even in the passion with which he proclaimed the need for a *Weltpolitik* as ultimate consequence and justification of Bismark's achievement. Weber strikes me as original and different from his contemporaries, when he insists on the diabolic character of the powers and the sacrifices that the empowered State requires. Treitschke, in his political lessons, found something ridiculous about small states. Weber rejoices that German settlements survive outside the frontiers of the German national state. Not only the modest bourgeois virtues and authentic democracy, that has still not come to exist in a big State, but values more intimate and nonetheless eternal that can only flourish in communities that have renounced political power.

"Having assumed that Russia was the principal enemy of the Reich, during the war of 1914-18 he recommended German policy favorable to Poland, except those that questioned the power of the German Reich. No more than he was prepared to sacrifice any changes in the West desired by the inhabitants. Since the power interests were supposed to be inseparable from the

Is City Bus Transport Being Stood On Its Head with Feet Up High?

The New York Times (4/02, "Rider Paradox: More Mass, Less Transit" by Michael Cooper) recounts what appears a somehow twisted tale: "St. Louis – Buses will no longer stop at some 2,300 stops in and around this city at the end of next month because, despite rising ridership, the struggling transit system plans to balance its books with layoffs and drastic service cuts.

"One stop scheduled to be cut if in the western suburb of Chesterfield, MO, just up the road from a bright, cheerful nursing home called the Garden View Care Center. Without those buses, roughly the kitchen' staff and half its housekeeping staff – people like Laura Buxton, a cook known for fried chicken who comes Illinois, and Danette Nacoste, who commutes two hours each way from her home in South St. Louis to her job in the laundry – will have no way to get to work.

"'They're going to be stranding a whole lot of people,' said Val Butler, a nurses' assistant at Garden View, who said she feared looking for work elsewhere in a tightening economy. 'A lot of people are going to lose their jobs. A lot of people.'

"St. Louis may be girding itself for some of the most extreme transit cuts in the nation, but it is hardly alone. Transit systems across the country are cutting service even when demand is up with record numbers of riders last year, many of whom fled $4-a-gallon gasoline gas prices and stop-and-go traffic for seats on buses and trains.

"Their problem is that fare-box revenue accounts for only a fifth to one half of the operating revenue of most transit systems – and transit systems depend on the sputtering economy and its state and local taxes to keep the transit systems running. 'We've termed it "the transit paradox," said Clarence W. Marsella, general manager of Denver's system, which is raising fares and cutting services to make up for the steep drop in local sales tax.

"The billions of dollars that Congress plans to spend on mass transit as part of the stimulus bill will also do little to help these systems with their current problems. That is because the new federal money – $12 billion was included in the version passed last week by the House, while the Senate originally proposed less – is devoted to big capital projects, like buying train cars or repairing tracks and stations. Money that some transit systems had proposed to help transit systems pay operating costs, and avoid layoffs and service cuts, was not included in the latest version.

"The Washington Metro set a record on Inauguration Day last month when people made 1.5 million trips on it to see the swearing-in of President Obama, but its $176 million budget gap means that it is planning to cut service and eliminate 900 jobs. Chicago had its biggest gain in riders in three decades last year, but was forced to raise fares.

"In New York City, the Metropolitan Transportation Authority is considering steep fare increases and its deepest service cuts in years to help close a $1.2 billion deficit. In addition to considering a 23% increase in fares and tolls, the authority is weighing plans to eliminate more than two dozen city bus routes and two subway lines, reduce off-peak service and even close some subway stations at night."

"William W. Millar, president of the American Public Transport Public Transportation Association, an industry group, wrote to the House speaker, Nancy Pelosi, last month urging her to include money for operating costs in the stimulus bill.

"Public transportation ridership is surging across the country,' he wrote, 'increasing 6.5% in the third quarter of 2008 – the largest quarterly increase in the past 25 years, but transit systems are cutting service and laying off employees as a result of increased transit fuel costs and declining state and local revenue sources that support transit.'

"In some respects St. Louis is unique. It was in the minority of transport systems that lost a ballot measure in November seeking more money; voters rejected a proposal to raise the local sales tax to pay for more public transportation. Transit officials said they believed their efforts had been hurt by lingering public resentment over a light-rail expansion project that was delayed and went over budget, devolving into messy litigation with contractors that ended costing the system even more.

"Faced with a yawning shortfall, despite an 8% increase in ridership last year, the system reluctantly decided to cut nearly half of its bus service. lay off, nearly 600 workers or a quarter or its work force.

"Some people who worked on the failed campaign to raise the sales tax said their efforts were complicated because most local voters do not regularly take public transport. But in the leafy suburbs west of Interstate 270, which are scheduled to lose almost all its bus service, many people will soon discover that even if they do not take the buses themselves, they rely on them to bring workers to their shopping malls, office parks, hospitals and nursing homes."

It all adds up to one great principle of mathematics and life itself: there is no use hiding a core social need under the table and pretending that it is not there.

W.K.

cultural interests (or at least of the cultural prestige interests). If he does not seem to be concerned about it, it is not because of immorality, but due to intellectual honesty. For everything tied to the laws of the 'power complexes' that governs political history.

"The political thinkers of the Occident have always noted the difference between the variations of the interior and exterior policies. When Hobbes, in the *Leviathan* seeks to illustrate the *state of nature*, he describes the relations between the sovereigns, and gives a radical expression to a classical idea. Max Weber, who clearly recognized that difference, proceeded to blur the distinction. It seems to me that he was impressed and a bit influenced by the Darwinian vision of social realities. For example: 'Whoever,' he writes, 'collects a penny of rent that others must pay – directly or indirectly – whoever some useful good or uses a means of communication due to the sweat and labour of someone either than himself, sustains himself by the sweat of others rather than by his own labour, is fighting another form of the war of man against man, in which hundreds of millions of men are consumed by the historic task imposed by destiny.' One can detect there the contribution to Max Weber of Darwinism to help explain the grimmer human economic relationships.

"Instead of the dream of peace and the happiness of all men, over the door of the unknown future there is written: *lasciate tutta speranza.*

"Such texts, so frequently cited, reveal, I believe what could be called the *Weltanschauung* of Max Weber, with a Darwinian ingredient (the struggle for life), a swathe of Nietzsche, an economic ingredient (the persistent scarcity of goods, the irremediable poverty of the people, a Marxist component (the classes have their individual interests that don't necessarily coincide with the eternal interests of the national community).

"Thirty years ago when I read Max Weber for the first time, I was struck above all by the intellectual courage and modesty that characterized his work. I still believe in what we can still learn from his writings. But today I am also sensitive to the metaphysical component the pessimistic vision so proper to these times, a vision of the society we live in purged of all illusion.

"A metaphysical conglomerate, partially Darwinian, partly Nietxcheen expressing the struggle for life, amongst the struggle of state powers, the economic rivalry of peoples. Max Weber set out from a Kantian and neo-Kantian opposition, contrasting what is and what should be – the gap between facts and values that is to be bridged did not reduce what should be to morality. He added that the universe of values are not only independent one from the others, but in inexpiable conflict. Something may be beautiful, not despite being bad, but because it is bad. (Les fleurs de mal.) From there he slipped into two propositions, both connected to *Machtpolitik:* the first that there is no court that can decide the relative value of German culture in comparison with French culture. The second that it is impossible to be at the same time a politician and a Christian (at least if Christian morality is that of the Sermon on the Mount). And that every one of us, in any action, must decide between the morality of conviction, and the morality of responsibility. And depending on which ethic we choose, we shall be driven to a radically different appreciation and action.

"I don't know how we would begin to settle scientifically the question of the value of French culture in comparison with German culture. Matters were very similar in the ancient world. The Greeks offered sacrifices to Aphrodite, then to Apollo, and then to each of the gods of the city. We do the same today, but we have broken the magic and we have deprived ourselves of the myth that, however, goes living on in us."

William Krehm

A Bump in the Road to Being Taken Seriously

As noted in the message I circulated yesterday (January 3), Wm. Krehm's current argument in favor of accrual accounting is for its application to investments in human capital (*ER* for December). By the way several of his articles on the topic are positioned in the magazine, it seems that they are a reaction to an item that I sent to him for possible circulation. (See "The Meltdown as Opportunity" on page 4 or visit the website. This is followed by Krehm's indignant rejection of the idea and his mistaken attribution of its content to me – p. 5.)

The main content is a draft by Michael Hudson that he is circulating among academic economists for endorsement. Since I know very few members of that species, I thought it would be interesting to put the announcement in *ER* and see if any of them emerge. The draft proposes debt cancellation in the current financial crisis, as an important step toward rebuilding national economies. The introductory and explanatory comments are by me, and they do provide both reasonable grounds for attaching at least some provisional credibility to Hudson's proposal and a notice of where they may be examined at greater length. (That will be in *Harper's Magazine* for March of this year.) The background is developed in many articles by Dr. Hudson in academic journals and in several of his books that are addressed primarily to the professional crowd.

Mr. Krehm dismisses Hudson's draft as glib (implying shallow) and scolds me for being naïve in "proposing" it (by repeating a clearly identified quotation by Hudson and attributing it to me). His reasons for this negative reaction are that "the unemployed across the world would be the first to suffer" and that the response of the powerful would be a military dictatorship. These bald assertions are made without the slightest effort of explanation or reference to historical precedent. This is ironical, given the regular laments in *ER* for the disappearance of historical context from university training programs for economists.

This disagreement, then, is the launching pad for the emphasis in subsequent articles (December *ER*) on accrual accounting and especially its application to "human capital." The disagreement is not a deep divide, however, for Hudson would endorse the recognition by government accounting of investments in human capital. Such investments, and those for physical infrastructure, are part of his policy stance and he sees them as more likely feasible in the aftermath of an orderly cancellation of unrepayable debts. What appears (to me) as a limitation of Krehm's prescription is that it applies primarily to the appearance of government balance sheets. But the great overhang of debt that is the accepted cause of our current crisis is part of the non-government financial sector.

The occasion of this misunderstanding also provides some illumination of the problem of being taken seriously that I have been addressing in this recent series. The take-off point for that consideration will be Mr. Krehm's invitation to Michael Hudson to comment on COMER's proposal (bottom of page 5).

Keith Wilde

(continues)

Reply

I received on January 4 from Keith Wilde a puzzling e-mail dated January 4: "As noted yesterday, Wm. Krehm's current argument in favor of accrual accounting is for its application to investments in human capital (*ER* for December). By the way several of his articles on that topic are positioned in the magazine, it seems that they are a reaction to an item that I sent to him for possible distribution. (See 'The Meltdown as Opportunity' on page 4 of the print edition or click on that title at the website. This is followed by Krehm's indignant rejection of the idea and his mistaken attribution of the content to me – p. 9.)"

I am puzzled that Keith should consider this as a reaction (above all an "indignant" one) to his suggestion for a discussion of that in a group. I am sure COMER would wish to participate, and certainly I would. I spend most days in such discussions and nobody can cite a case where I or any other member of COMER discouraged them.

The proposed draft for the discussion is stated as debt cancellation. As Keith must know the problem with much of the debt in question is that it is collateralized debt and hence depends on the validity of the collateral which makes that difficult. Since often there is no market, it is ambiguous and not marketable. But that is what discussions are for.

There is a further puzzle is that Keith should my "current argument seems a reaction to an item that I sent to him for possible circulation.

Let me briefly sum up how long it was before I had even heard of Keith Wilde that I became completely involved with accrual accountancy. It was in the 1960s that it occurred to me that the new wave of price increase unleashed by the deregulation of the economy could not be wholly ascribed to "inflation," properly defined, i.e., too much demand and not enough supply across the economy to satisfy it. First, I made the point that no proposition can be turned around and automatically considered as equally valid in its new form. If I hold a loaded gun to my head and pull the trigger, I fall dead. But that doesn't mean that if I drop dead, I have shot myself. It could have been heart failure or thousands of other causes. Only orthodox economists seem unaware of this I identified the price contemporary price surge with the rapid urbanization of the world, the high tech developments that required a far more educated population. Nobody moving from a town of 5,000 to New York is fool enough to expect his cost of living to remain the same. Then how can we expect that when most of humanity undergoes a similar displacement? This layer of taxation which pays for such additional public services I called "the social lien."

Having done this, I wrote a lengthy article and sent it to 30 economic publications. One of these, *La Revue Économique* of Paris, bought and published it. It received favorable reviews from a few journals including the *Economic Review* of the Economics Department of Cambridge University in Britain. It was only when I became acquainted with what was afoot amongst a considerable section of French economists that I understood why it was published in France and led to close ties to François Perroux, one of the most productive of French economists.

In 1962 P. Biacabe had decided from his statistical studies that prices often rose when there was no excessive demand over supply. His conclusion: there was a still unidentified factor in price increase that had not been identified. In 1969 J.P. Mockers from a different batch of statistics arrived at the same conclusion. That explains why my article had been immediately published. At the same time I received a letter from the prominent publisher Calmann-Levy, asking whether I would write a book on the subject. I did so, without troubling about a contract. When I submitted my manuscript a year later, they had lost interest. I published the book myself in English. *La Revue Économique* has long since gone out of existence. The French economic scene has been levelled.

I recount all this to explain how bizarre Keith Wilde's notion that it was my anger (why anger?) over his advancing another way of dealing with the monetary and financial crisis that has overtaken the world. I would happily participate in the discussion meeting he is helping to organize. And what I will emphasize that the debt that the organizers of the conference must get out of the way is for the most part heavily collateralized. Having government acquire too much of it will threaten converting our legal tender – strictly government debt – into subprime legal tender.

On the other hand one of the great positive lessons of WWII was that investment in human capital – education, health, the environment – is the most profitable investment a government can make. That was proved by the rapid recovery of Japan and Germany from the destruction of World War II, contrary to the predictions of the hundreds of economists that Washington sent to those countries at the end of the war to predict how long it would be before they could hope to become the formidable competitors on world market that they had been. One of these, Theodore Schultz later in 1961 summed up his conclusion: "We missed our mark because we concentrated on physical destruction and overlooked that the highly educated and disciplined work force had come out of the war virtually intact. Hence the conclusion: human capital is the most productive investment a government can make."

We have, moreover the example of the physical government assets, until then "depreciated" in a single year while the debt that paid for them was "amortized" over some decades. The result was a huge apparent debt that was not really there, and fabulous opportunities of privatizations for the well-connected to profit by. When accrual accountancy was brought in and extended to 1959, somewhere over 1 trillion and 1.25 trillion dollars of assets were recovered. Given the expansion of the economy since then, and the more productive nature of human investment as proved by Schultz, a likely recognition of human capital now ignored is likely to approach $3 trillion. Briefly decorated and celebrated and since almost completely forgotten except by a very few organizations like COMER, we can readily assume that there is at least top-notch investment there – completely paid for, with no collateral debt to get rid off. There is this, too, just as the children of educated people tend to be more readily educated, more healthy and adjustable to their milieu. Careful spending of this wholly paid for human investment will instead be more investment than expenditure.

And if some of the banks' profit from such double-entry accountancy, they could in return be required to surrender what rights there are in their charter to authorize them to engage in non-banking financial pillars – mortgages, insurance, credit cards, or stock brokerage.

Surely after the introduction of the accrual accountancy in recording physical capital, it is a cookie-cutting chore transferring the experience to human investment. This in no way, of course, excludes a mixture of what it is that Michael Hudson or any one else is proposing, provided that the by now considerable experience we have in bailing out our banks would seem to warrant it.

William Krehm

Russia's Decades as Communist Country have not Helped It Resist the Menaces of the Oil Market

You might imagine that those bloody decades as a communist land would somehow equip Russia to resist the trials of capitalist markets at their worst. Not a shred of evidence of that. *The Wall Street Journal* (19/12, "Oil's Crash Stirs Unrest In Russia Hits Home" by Andrew Osborne and Alan Cullison) draws quite the opposite reaction: "Barnaul, Russia – Russia's oil-fired economic miracle is unraveling as industry shrinks and job losses mount. Now the first stirring of social unrest have the Kremlin groping for a response.

"Gloom deepened over the outlook for oil-export revenue, Russia's main earner, as prices plunged Thursday despite OPEC's move to deeply cut production. Oil hit a 4 1/2 year low on anxiety about falling global demand, with crude closing at $36.22 a barrel in New York, down $3.84. This could spell trouble for Russia, which has pegged its 2009 budget on much higher oil prices, meaning it will have to trim spending.

"The drop in oil prices is eroding the Kremlin's ability to replenish its gold and foreign currency reserves just when it needs them most. Although the country's reserves are the world's largest behind China and Japan, it has been spending tens of millions of dollars to prop up the falling ruble and stave off public panic.

"The central bank let the currency slide more quickly Thursday, the third mini-devaluation in four days. The currency has lost more than 11% against the dollar-euro basket since August, when it hit its historic peak.

"Prime Minister Vladimir Putin on Thursday painted a bleak picture of the economy. Since October, more than 7,500 firms have informed the government they intended to lay off people, 207,000 workers have had their working hours reduced, he said, calling these 'worrying signals.'

"The government is drawing up a list of the most significant enterprises that might need a bailout, Mr. Putin added. That would come on top of the more than $200 billion the Kremlin has already pledged to shore up the economy, and will cover a minimum of 1,500 firms. Deputy Economy Minister Andrei Klepach said on Thursday that this economy wouldn't grow again until the middle of next year.

"The Kremlin has tried in state media to downplay the impact of the global financial crisis. Yet popular discontent is growing.

"Last weekend, thousands of angry residents in the far eastern city of Vladivostok took to the streets and blocked traffic to protest government plans to raise tariffs on secondhand foreign cars, one of the impoverished region's biggest earners. Similar protests have been attempted in Moscow, St. Petersburg and Kaliningrad recently, and further demonstrations are planned for Sunday in Vladivostok."

Growing Angst Over Financial Crisis

"Public anger also spilled onto the streets this fall in the Siberian town of Barnaul, as thousands of pensioners who had lost their right to discounted public-transport tickets staged noisy protests.

"The government's response says a lot about the Kremlin's growing angst over the financial crisis. After several tense days, the pensioners got their discount tickets back, police detained younger protesters who had joined them and state media made little mention of the event.

"The prospect of further unrest poses what could be the biggest challenge yet to the authoritarian system built by Mr. Putin. It also foists a stark choice on the Kremlin: to stifle dissent, or to placate protesters by providing some kind of pressure outlet. For now the Kremlin has decided on a mixture of both. But the government's options may narrow as its financial reserves shrink.

"'They're incredibly scared of this,' says Yevgeny Gontmakher, and economic adviser to the Kremlin. 'They don't know how to operate in this environment.'

"Previous periods of low oil prices in the 1980s and 1990s contributed to the downfall of two Kremlin administrations – those of Mikhail Gorbachev and Boris Yeltsin."

It used to be the proletariat inspired by Marx who overthrew governments, and now it is low oil prices!

"Often, social discontent has begun in Russia's far-flung regions, where Kremlin control is comparatively tenuous.

"Russia is just beginning to feel the impact of a slowdown that economists say could take the economy from nearly 8% growth earlier this year to near recession in the next few months. Wage delays have already led to a strike by workers on a construction site in the Ural mountains city of Yekaterinburg. Such social protest has been rare in recent years amid widespread political apathy and fear of government retribution.

"Russia posted its first monthly budget deficit in November as falling oil prices and slowing production battered the economy. Meanwhile, Standard & Poor's has downgraded Russia's sovereign debt for the first time in 10 years.

"Public panic is one of the Kremlin's greatest fears. 'I've already seen how things get worse as the result of an oil-price collapse,' says Yegor Gaidar, who was acting prime minister in 1992. 'It's dangerous – but people who have not governed a nuclear-armed country don't quite understand that.'

"The Kremlin has recently begun to talk publicly about the financial crisis. Before, it was seldom mentioned on state TV. Membership of a Kremlin advisory body that monitors the media say that officials told journalists not to use the word 'crisis.' The Kremlin has accused the West and home-grown economic liberals of using the crisis to fan discontent. In a recent question-and-answer session with voters aired on Russia's two main state television channels, Mr. Putin blamed Russia's problems on 'financial and economic authorities' in the US. They had 'infected' the global economy, he said. Meanwhile, lawmakers in his party have turned on Finance Minister Alexei Kudrin, complaining about the speed at which reserves are being spent on anti-crisis measures. Mr. Kudrin has said that the money is being spent 'accurately.'"

A Lack of Trust and Cash on Lenin Avenue in Barnaul

"This fall, Barnaul, an ailing Siberian industrial hub some 2,000 miles south of Moscow and one of the last regions to benefit from the oil boom, became one of the first to feel the crisis.

"As the credit crunch poisoned Russia's economic supply chains broke down on a lack of cash and trust, and orders dried up at the town's factories, which churn out diesel engines, heavy machinery and tires.

"Three months ago, workers say, several factories sent workers home on reduced salaries until better times. Government data show over 1,000 workers in the region are in the process of being laid off; opposition lawyers say hundreds more layoffs are likely.

"In late October, when authorities revoked subsidized transport tickets for more than 200,000 pensioners in Barnaul, they gave no warning nor explanation. When the pensioners – among the poorest groups in Russia – learned the tickets were being axed, they panicked.

"On Oct. 26, about 1,500 gathered in front of the regional government building to protest, according who attended. The pensioners blocked the town's main thoroughfare, Lenin Avenue for three hours, and dispersed only after a local government official invited a few of the leaders inside for a chat, promising that the tickets would reinstated.

"Still, protesters came back the next day. This time they numbered only a few hundreds but demanded the resignation of the local Kremlin-appointed governor.

"In a third protest, a crowd of 2,000 again blocked Lenin Avenue as regional lawmakers debated the decision to do away with the discount. Some demonstrators tried to storm the government building, but police lines held. The governor tried to calm the crowd, but was forced to retreat.

"Eventually, the government decided pensioners could keep their discounted transport tickets, while a new system allowing them to choose between cash payments and free transport passes is introduced.

"Political opponents believe remote regions and towns like Barnaul are the Kremlin's Achilles heel. 'They can only control what's within the Moscow ring road,' says Vitaly Boldakov, a left-wing activist in Barnaul. But beyond that road, their control collapses."

These are then some unsuspected weaknesses in the might of the world's second power armed with nuclear outer space weaponry.

W.K.

Meltdown Volume 3 is now available. See the Bookstore on page 8 for details.

The Difficulty of Fitting the Thread Through the Fed's Eye

The Wall Street Journal (20/01, "The Fed is Becoming a conglomerate" by Serena Ng and Liz Rappaport) minces no words: "It has loads of subprime-mortgage bonds, souring commercial real estate, and collateralized debt obligations worth a fraction of their original value. This isn't Citigroup Inc. or Merrill Lynch. It is the Federal Reserve.

"In the past year, the Fed lent out more than $1 trillion in its efforts to stabilize the financial and credit markets. A chunk of that was used to buy mortgage-related securities and loans in the rescues of Bear Stearns Cos. and American International Group Inc., as well as other debt shunned by investors.

"Now, the government's recent aid packages for Bank of America Corp. and Citigroup have the Fed playing the additional role of a backstop guarantor for portfolios of about $400 billion in troubled assets that were dragging down those banks. These assets include residential and commercial mortgage loans, mortgage securities, corporate leveraged loans and credit-derivative positions.

"As the US central bank, the Fed has a mission to maintain financial and economic stability and contain systemic risk in the markets. It lends only when the loans can be 'secured to its satisfaction,' according to laws that govern the Fed's activities."

There is a key novelty in the monetary set up that has condoned both the banks and the Fed slipping down that treacherous slope. In 1970, largely because of Washington's entanglement in the Vietnam War, it abandoned the gold standard. This analysis is in no way a defence of or nostalgia for the gold standard. It was rarely what it was reputed to be even in a far less tumultuous world. There was rarely enough gold to go around. But it created the illusion that money and sovereign credit was something you could test with you knuckles. Today everything is debt – and with the drop in the standard of economics courses in our universities, the difference between the debt of a great sovereign land with its taxing powers on every domestic product or even asset in the land, and the debt of a wildly extended corporation or bank is so beyond comparing that it becomes antithetical, And by saddling the central bank with the debt that has twisted and crippled private banks in their growth mania, unless we grasp and protect that distinction, we are lost in the woods.

Returning to the *WSJ:* "The Fed's lending could well swell by another $1 trillion or more in 2009 as its liquidity programs are tapped further by borrowers and it purchases more bonds, such as those issued by Fannie Mae and Freddie Mac, as well as by student loans auto loans credit-card receivables and small-business loans.

"The result would be a Federal Reserve balance sheet several times its size 18 months ago, when most of the Fed's assets were Treasury securities.

"While the Fed has never had a loss before, notes James Bianco, a president of Bianco Research in Chicago, its record may not mean much today. 'It's a whole new ballgame for them. We've never seen anything like this in terms of the Fed broadening its reach before.'

"The Fed's program to lend up to $200 billion to purchase securities backed by consumer and small-business loans will be protected by a $20 billion contribution from the Treasury. That means losses from the securities would have to exceed $20 billion before the Fed's loan is impaired.

"The Fed would be exposed to losses on the assets of Citigroup and Bank of America only after the banks themselves and other government entities have absorbed tens of billions in losses. But if that happens, the central bank's exposure to risk could balloon. The Fed has committed to Citigroup and about $90 billion to Bank of America, though it is unlikely that much will be needed.

"Maiden Lane II LLC and Maiden Lane III LLC, created late last year to hold illiquid subprime-residential mortgage-backed securities previously owned by AIG, as well as collateralized debt obligations in insured, have so far not reported substantial write-downs that would impair the loans of roughly $43 billion the Fed has provided to the two companies.

"Those securities were worth about half their original values at the time they were purchased by the two firms, and AIG agreed to absorb initial losses up to $6 billion. Their performance is largely tied to that of subprime borrowers."

K.