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An Incongruity of Commitments

Neil Reynolds (*The Globe and Mail,* 07/05, "Many moons to go: The promise of lunar mining") makes a shattering comparison: For $1 billion, Canada convened a summit weekend session of assorted world leaders who, as they left, produced an ambivalent communiqué of improbable historic importance. For $3.2 billion worth of such summitry, several of these same countries paid for the US – European Cassini space mission to Saturn, a 3.5 billion kilometer, seven-year voyage that has revealed the secrets of Saturn's strange orange moon, Titan. It turns out that Titan is awash in liquid hydrocarbons – and in the moon's light gravity, each drop floats down from the clouds at roughly the speed that large snowflakes fall to Earth.

"With only one-fifth of this moon radar-scanned so far, scientists calculate that dozens of lunar lakes each hold more oil and gas than all of the Earth's proven oil and gas reserves – and that Titan's equatorial sand dunes hold hundreds of times more coal than all the Earth's proven coal reserves. Titan is a vast reservoir of hydrocarbons. Talk about Peak Oil.

"The Cassini mission is an example of intelligent government enterprise. Although the US paid 80 per cent of the mission's costs ($2.6 billion), Europe participated financially and scientifically by providing the Huygens space probe – the 'lander' that hitchhiked a ride aboard the Cassini spacecraft, launched from Cape Canaveral in 1997, which reach Saturn seven years later in 2004. The lander separated from the spacecraft on Christmas Eve, 2005, and touched down on the Titan surface three weeks later – immediately transmitting information back to Earth by telemetry.

"The Cassini mission itself was supposed to end in 2008 after 50 'flybys,' or circumnavigations of the moon, each successively closer to the Titan surface. So successful was the mission that the US kept extending it. In June, the Cassini spacecraft made its 70th flyby – and has authorized 155 flybys.

"Writing in 2008, physicist Ralph D. Lorenz described in scientific journals the terrain of Titan (temperature: minus 179 degrees Celsius) as confirmed by the mission's radar-imaging technology. 'Titan is just covered in carbon-bearing material,' he said. 'It's a great factory of organic chemicals.'

"It doesn't rain methane often, but it makes up for it with massive once-in-a-century downpours.

"*New Scientist* magazine has reported that Cassini mission data make a circumstantial case for a primitive life form on Titan: a microbe that lives on lakes of liquid methane, that breathes hydrogen, that eats acetylene – and that manufactures methane as a waste product. The profound difference with Earth notwithstanding, Dr. Lorenz has called Titan 'the most Earth-like body in our solar-system,' and has predicted that it will be 'a key target' for future space exploration.

"We don't need to travel billions of kilometers, however, to find a landscape with abundant energy resources. Our own moon is a mere 384,000 kilometres away, four days by shuttle – less time than it takes to truck grapes from California to Toronto. China, for one, now appears to understand the importance of the Earth's moon: Chinese geochemist Ouyang Ziyuan, director of China's Space program in the mining of Helium-3, a non-radioactive isotope scarce on Earth but relatively plentiful on the moon.

"By some calculations (including China's), a four-ton shuttle-load of lunar Heli-

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How Our Governments are Preparing for the Human Capital to Handle Mining on a Moon of Saturn

The New York Times (24/06) clues us in on the diligence with which our governments are preparing the challenge of mining non-polluting coal on a very special moon of the distant planet Saturn. In an article entitled "Community Colleges Cutting Back on Open Access" by Tamar Lewin, we read: "Walnut, Calif. – When Giovanny Villalta tried to register for winter-term classes at Mount San Antonio here, he hit the wall.

"'I was assigned a late registration slot, and by the time I was allowed to register, everything was full,' Mr. Villalta said. 'Biology, full. Anatomy, full. Physics, full. Psychology, full. History of Asia, full. Any history class that would count toward transferring to four-year UC campus, full.'

"'It was pretty frustrating,' he said. 'You feel like you're wasting time, and your life's just going by.'

"In this economy, community colleges are widely seen as the solution to many problems. Displaced workers are registered in droves to earn credentials that might get them back in the game. Strapped parents, daunted by the cost of four-year universities, are encouraging their children to spend two years in the local community college.

"President Obama has announced an American Graduation Initiative to produce five million more community college graduates by 2020. There is even a popular television comedy, *Community*, set at two-year college.

"We're more visible now than we ever have been, said George R. Bogges, president of the American Association of Community Colleges.

"But for students and professors at over-stretched colleges, these are hardly the best of times. With state financing slashed almost everywhere, many institutions have cut so deeply into their course offerings and their faculty rosters that they cannot begin to handle the influx of students.

"In some parts of the country, the budget stresses are so serious that the whole concept of community colleges – where anyone, with any educational background, can enroll at any point in life – is becoming more an aspiration than a reality.

"'We have a commitment to educate the top 100% of Americans, but this is a tough time,' said Martha J. Kanter, under secretary of a former community college president. 'Students aren't getting as many classes as they want, so it's going to take them longer to get through.'

"On the sunny, hilly campus of Mount SAC (as everyone calls it) east of Los Angeles, Ashley Diaz is one of many dispirited students. In each of her three terms at the college, she has been able to get into one academic class and one dance class, which she has taken three times.

"'I came in with some advanced placement credits, so I don't need that many courses before I can transfer to a four-year university,' Ms. Diaz said. 'I thought I'd be in and out in a year and a half, maybe two. But it's like working my way through quicksand.'

"Many students feel stalled, whether they plan to continue at a four-year university or become a fire-fighter, a nurse, or a welder….

"The college has cut 800 course sections – more than 10% of its classes – over the last year, even as the number of people attending pre-registration orientation sessions has grown about 10 percent.

"'We want to create the illusion that we're still open access,' said Silver Calzada, chairman of counseling at the college. 'But the truth is that with all the classes that have been cut, unless you get a registration slot on the first or second day, you're not going to get into the classes you need. Students see our banner saying "Dream It. Be It." and they feel like they've been duped.'

"Open access has passed its limits elsewhere, too. For the first time, the City University of New York and its six community colleges, whose enrollment grew by 43% over the last decade, started waiting lists for admission this fall.

"'We capped our enrollment for the fall at 10,804, the same level as last year,' said Eduardo J. Marti, president of Queensborough Community College. 'That means

that there will be about 200 to 500 students we might not be able to bring in.'

"Even in flush times, completion rates at community colleges are shockingly low, in part because so many students hold jobs and attend classes only part time. Over all, only about a quarter of community college students complete their degrees in six years, said Ms. Kanter, the education undersecretary. Then, too, most need some remedial courses before they can begin college-level work.

"Recently. Foundations like the Bill and Melinda Gates Foundations and Lumina have been pouring money into community colleges to increase completion rates, in part by improving remedial education.

"Almost everywhere, anatomy and physiology classes, and others required for students of health professions, fill up almost instantly, and admission to health-related programs can take years."

However, the sad tale does not end on that sad note. It gets still worse.

Immediately below the report of the faltering access to community colleges the *Times* carries another entitled "For-Profit Colleges Find New Market Opportunities" by Tamar Lewin. We quote: "Kaplan University has an offer for California community college students who cannot get a seat in a class they need: under a memorandum of understanding with the chancellor of the community college system, they can take the online version at Kaplan, with a 42% tuition discount.

"The opportunity would not come cheap. Kaplan charges $216 a credit with the discount, compared with $26 a credit at California's community colleges.

"Supporters of for-profit education say the offer underscores how Kaplan and other profit-making colleges can help accommodate the mushrooming demand for higher education.

"The number of California students choosing for-profit schools has been increasing rapidly, state officials say.

"At the same time, government officials have become increasingly concerned that students at for-profit colleges are far more likely than those at public institutions to take out large loans – and default on them.

"For better or worse, the tough times for public colleges nation-wide have presented for-profit colleges with a promising marketing opportunity. 'We thought, in light of the budget crisis and the number of community college classes being canceled, if we had the same class here, we would give students the opportunity to take it at Kaplan,' said Greg. F. Marino, president of Kaplan University Group, a profit-making business owned by the Washington Post Company.

"Kaplan signed the memorandum of understanding seven months ago.

"In Massachusetts, Bristol Community College, which has to turn away many qualified applicants for its nursing and other courses in the health professions, has entered into a partnership with Princeton Review.

"The Review, a private company, will expand the programs – and then charge $8,000 tuition, about double the regular Bristol rate.

"'It will be our students, our courses, our curriculum, taught by our faculty, but Princeton Review's going to pay some of the startup costs,' Sally Chapman Cameron, a Bristol spokeswoman said of the two-tiered pricing plan. 'Some private colleges nearby charge a lot more than Princeton Review will. Our region needs more health care workers, and without this partnership, we don't have the resources to expand our nursing program.'

"In California, the memorandum of understanding also requires each community college taking part to sign a credit-transfer agreement with Kaplan – and most of the state's 112 colleges are not eager to do so. Thus far, Kaplan has no takers for its courses.

"'Faculty from across the state were uniformly irate and disappointed about the memorandum of understanding,' said Jane Patton, president of the Academic Senate for California Community colleges, partly because faculty members were not consulted.

"At the academy senate's spring meeting, faculty members voted to urge the chancellor to withdraw from the memorandum of understanding, which they said 'signaled the chancellor's willingness to out-source the California community colleges' mission to private for-profit universities."

W.K.

Games Played

The Wall Street Journal (20/06, "Fast Traders Face Off With Big Investors Over 'Gaming'" by Scott Patterson) provides a rare insight of shifting from mathematical simple-mindedness to involved "algorithmic" mathematics, to cover up what our gambling banks have done to take over the economy.

"A high-tech, high-speed poker game is playing out in the stock market, and billions of dollars are at stake.

"The adversaries are high-frequency traders and big investors such as mutual funds. High-speed firms are using computers to detect large buy and sell orders, trying to pick off pennies per trade in the process. Traditional traders are scrambling to trade undetected.

"The showdown has led to an escalating arms race, with players on both sides plowing money into ever-more-powerful technology to trade effectively. It also has led to growing tension between these camps as conventional investors call for greater regulation of their high-frequency counterparts.

"The clash came to the fore after the May 6 'flash crash,' which underscored the rising use of computers and algorithms [use of letters or other mathematical symbols to express arithmetic relationships] to trade stocks. In testimony last week before federal regulators investigating the market plunge, high-speed firms contended they are misunderstood and that critics spread false rumors about their trading methods. Traditional money managers said fast traders have harmed their ability to trade stocks and regulators need to step in.

"'Attempts to classify some trading styles as "desirable" or "undesirable" are unproductive,' said Dave Cummings, chairman of Tradebot Systems Inc., a Kansas City, Mo., high-speed firm at the June 22 hearing [of the Financial Crisis Inquiry Commission].

"Jeff Engelberg, a trader at Southeastern Asset Management Inc., a Memphis, Tenn., value investing firm with about 35 billion [dollars] under management, said high-speed traders are jumping ahead of his firm's trades. 'Short-term traders are able to get an instantaneous glimpse into the future through direct feeds to exchange data,' he said, 'turning the market into something nearer to a casino.'

"High-frequency trading accounts for about two-thirds of US stock-market volume, according to industry estimates. Advocates of the practice include some heavy-hitters, such as mutual-fund giant Vanguard Group Inc., which says it helps lower trading costs by narrowing the spread between what investors pay to buy and sell shares.

"Traditional money managers largely agree that some costs have dropped. But some say that some trades have become more expensive to carry out, thanks to a practice critics call 'gaming.' With gaming, if a high-speed firm's computers direct a large buy order for a stock, for instance, the firm will instantly start snapping up the stock, expecting to quickly sell it back at a higher price as the investor keeps on buying.

"Phillip Krauss, head of stock trading at Chicago's Harris Investment Management, Inc., a Memphis, Tenn., says his firm's orders are getting picked off by high-speed trading firms that use computer programs to detect orders. 'They front-run us,' said Mr. Krauss, whose firm manages $15 billion in assets."

Gaming Front Runs

"To protect themselves, traditional investors like Mr. Krauss are stepping up investments in 'anti-gaming' computer power and expertise. Big firms such as Bank of America Corp., acting on behalf of thousands of investors who trade through its vast brokerage network, have been rolling out high-tech platforms to help their traders avoid getting gamed.

"'Anti-gaming was a big focus for us last year and it's going to be a big focus for us this year,' says Lee Morakis, head of sales for Bank of America's execution services for the Americas unit.

"On Capitol Hill, Sen. Ted Kaufman (D., Del), an advocate of regulation of high-speed trading, said his office has been fielding complaints from players across Wall Street who say gaming is tilting the field against them.

"The Securities and Exchange Commission in January issued a report outlining its concerns about high-frequency trading and related consequences of recent changes in the structure of markets. The agency recently unveiled a plan to give large high-frequency firms unique identification codes to better track their activities.

"While gaming isn't blamed for the May 6 crash, that day's downdraft has increased scrutiny of high-speed trading generally. High-speed firms have touted their ability to smooth trading by constantly stepping in to buy and sell stocks. But when trading became chaotic that day, many of these firms – along with other investors – pulled back.

"Thirty-eight percent of so-called buy-side money managers – typically long-term investors – say they have a more negative view of high-frequency trading than before the flash crash, according to a recent survey by Tabb Group; 17% expressed positive views.

"In many ways, the gaming dynamic isn't new but instead represents an evolution of the market. Wall Street insiders have always tried to use information about competitors' intentions to gain an edge.

"Note, information is embedded in streaming market data and computer codes. Algorithms are expected to account for about 60% of stock-trading this year, up from 28% in 2005, according to Aite Group, a Boston firm that tracks electronic trading.

"A sharp fall in trading size shows the impact of algorithmic trading, which is typically done in 100- or 200-share chunks. The average size of a trade of a stock listed on the New York Stock Exchange was 268 through most of 2009, down from 724 in 2005, according to the SEC.

"That has made it much more difficult for traders to buy or sell huge chunks of stocks. Now, traders must parcel out orders in tiny bits – and high-speed firms are monitoring the activity for signs of a big trade.

"Henri Waelbroek, research director of New York electronic brokerage Pipeline Financial Group Inc., has designed a trading system that alternates algorithms to keep gamers off the scent of big trades. 'You need to understand what the games are and how to defend yourself,' Mr. Waelbroek said."

What it calls to mind is the early days after the collapse of the Roman empire and highways were no longer policed, merchants who traveled with their goods no longer dared carry money with them. Instead they used instructions to a goldsmith at their destination authorizing him to release to them moneys left for safekeeping by a previous merchant bound in the opposite direction. It was an early source of what eventually became banking when the goldsmith noted that for months or longer money left with him lay idle. and decided that he could lend it out at interest if he were able to meet the claim its owner on presentation of the proper paper. Our internet today, our economy, and our society are as badly controlled as those roads of medieval Europe, and we have reverted to carrying little cash or betraying where it might be found.

However, the dubious moral side-effects of algorithmic snooping on other folks' buying orders lead to even more basic questions. There is a howling contrast between how our economic masters and the governments muster complicated mathematical algorithms that permit one group of arch-traders to intercept the trading *intentions* of others while, on the other hand, when it comes to running the economies of our globalized, deregulated world, the mathematics known to a first-year high-school student are deemed beyond our heads of state.

For in the first week of the first-year high-school algebra course they taught us that to solve a problem involving two variables of the first degree, you needed two such independent equations. One could not do. The procedure is simple: you multiply one equation so that the coordinates are the same for one variable and you subtract one equation so altered from the other and what remains gives the value of the other variable, and hence of the other. If you have three independent variables in the linear equations that you are to solve, you need three independent equations and by the same procedure repeated twice, you get your solution. And if you are trying to solve the problems of a globalized deregulated world, the number of equations to solve would run into the millions. Nevertheless our governments are trying to solve them with equations with two variables, and what results is not a solution but the Toronto G20. And that is a guarantee of crescendoing crises ahead, leading to the ultimate gamble – atomic war.

Now contrast the readiness with which our governments are prepared to study and accept the algorithmic internet penetration of other traders' intended trades with their rejection of the immensely simpler mathematical criteria that permitted President Roosevelt to find his way out of the Depression. And closer home, in Canada, permitted a high-school drop-out, G.G. McGeer, first as a leader of a trade union and then as Mayor of Vancouver and, finally as a member, a member of the federal parliament to convince PM Mackenzie King to nationalize the Bank of Canada in 1938 by buying out 12,000 private shareholders of the Bank of Canada that had been founded as a private bank four years earlier. That allowed Canada to finance her part in World War II on better terms than either Britain or the US. Britain's central bank was nationalized only *after* the war, and the American Federal Reserve system is still partly owned by the central government while the local Fed banks are in private hands.

That and the statutory reserves that allowed the central bank to deal with an overheated economy, without depending wholly on higher interest rates. The alternative to higher interest rates was the statutory reserve that required the banks to make

deposits with the central banks on which they received no interest. This provided an alternative to depending wholly on higher interest rates to rein in an overheated market. Our nationalized central bank and the restraints on our banks acquiring interests in other "financial pillars" such as brokerages, insurance and mortgage companies, allowed Canada after the war to catch up with the neglect of its infrastructures during a decade of depression and five years of war, renew its infrastructures, industrialize the country receive and assimilate millions of mostly penniless European immigrants.

Today, however, all that has been forgotten, as has the mathematics we learned in the first week of algebra lessons in the first year of our high school, as too "hard for our public and our Minister of Finance to understand."

W.K.

The Fictions of Our Mega-Banks Set the Patterns for Society Itself

The Wall Street Journal (0807, "To Fix Sour Property Deals Lenders 'Extent and Pretend'" by Carrick Mollenkamp and Lingling Wei) tells a topsy-turvy tale: "Some banks have a special technique for dealing with business borrowers who can't repay loans coming due: give them more time, hoping things will improve and they can pay later.

"Banks call it a wise strategy. Skeptics call it 'extend and pretend.'

"Banks are applying it, in particular, to commercial-estate lending, where, during the boom, optimistic borrowers got in over their heads to the tune of tens of billions of dollars.

"A big push by banks in recent months to modify such loans – by stretching out maturities or allowing below-market interest rates – has allowed a spike in defaults. It also helped preserve banks' capital, by keeping some dicey loans classified as 'performing' and thus minimizing the amount of cash banks must set aside as reserves for future losses.

"Restructurings of nonresidential loans stood at $23.9 billion at the end of the first quarter, more than thee times the level a year earlier and seven times the level two years earlier. While not all were for commercial real estate, the total makes clear that large numbers of commercial property borrowers got some leeway.

"But the practice is creating uncertainties about the health of both the commercial-property market and some banks. The concern is that rampant modification of souring loans mask the scope of the commercial property market weakness, as well as the damage ultimately in store for bank balance sheets.

"In Atlanta, Georgian Bank lent $13.5 million to a partnership in late 2007 to buy land for a 53-story luxury Mandarin Oriental hotel and condo development. When the loan came due in November 2008, the bank extended its maturity date by a year. Then the banks extended it again to May 2010, with an option for a further extension to November 2010, according to court documents.

"Georgia's banking regulator shut down the bank last September. A subsequent US review cited 'lax' loan underwriting and 'an aggressive growth strategy…that coincided with declining economic conditions in the Atlanta metropolitan area.' Some of Georgian Bank's assets were assumed by First Citizens Bank and Trust Co. of Columbia, SC, which began foreclosure proceedings on the still unbuilt luxury development. The borrowers contested the move, and settlement talks are in progress.

"Also in Atlanta, Bank of America Corp. has extended a loan twice for a high-end shopping and residential project. Three years after a developer launched the Streets of Buckhead project as a European-style shopping district, all there is to show for it is a covey of silent cranes and a fence. The developer, Ben Carter, says he is in final negotiations for a private investor to come in and inject $200 million into the languishing development.

"Regulators helped spur the banks' recent approach to commercial real estate by crafting new guidelines last October. They gave banks a variety of ways to restructure loans. And they allowed banks to record loans still operating under the original terms as 'performing' even if the value of the underlying property has fallen below the loan amount – which is an ominous sign for ultimate repayment. Although regulators say banks shouldn't take the guidelines as a signal to cut borrowers more slack, it seems some did."

Banking on Tomorrow

"Banks hold some $176 billion of souring commercial real-estate loans, according to an estimate by research firm Foresight Analytics. About two-thirds of bank commercial real estate loans maturing between now and 2014 are underwater, meaning the property is worth less than the loan on it. Foresight data show US commercial-real-estate values remain 42% below their October 2007 peak and only slightly above the low they hit in October 2009, according to Moody's Investor Service.

"In the first quarter, 9.1% of commercial-property loans held by banks were delinquent, compared with 7% a year earlier and just 1.5% in the first quarter of 2007, according to Foresight.

"'Holding off on foreclosing is often good business,' said Mark Tenhundfeld, director of regulation policy at the American Bankers Association. 'It can be better for a bank to extend a loan and increase the chance that the bank will be repaid in full rather than call the loan due now and dump more property on an already-distressed market,' he says.

"But continuing to extend loans and otherwise modify them, rather than foreclosing, amounts to a bet that the economy will rebound enough to enable clients to find new demand for the plethora of offices, hotels, condos and other property on which they have borrowed. If it doesn't work out this way, the banks will end up having to write off the loans anyway.

"At that point, if they haven't been setting aside sufficient cash all along for potential losses on such loans, the banks will face a hit to their earnings.

"Banks' reluctance to bite the bullet on some deteriorating commercial real estate can have economic repercussions. The readiness to stretch out loans puts a floor under commercial real estate and keeps it from hitting bottom, which may be a precondition for a robust revival.

"More broadly, the failure to get the loans off the banks' books tends to deter new lending to others. It's a pattern somewhat reminiscent, although on a lesser scale, of the way Japanese banks' failure to write off souring loans in the 1990s contributed

to years of stagnation.

"It's a Catch-22 for banks. As long as some of their capital is tied up in real-estate loans that are struggling – and as the banks see as pipelines of still-more sour real-estate debt that will mature soon – their lending is likely to remain constricted. But to wipe the slate clean by writing off many more loans would mean an even bigger hit to their capital.

"'It does not take much of a write-down to wipe out capital,' says Christopher Marinace, managing principal at FIG Partners, a bank research firm. Federal bank regulators tackled the issues in October with a 33-page set of guidelines. Bank regulators have said they were concerned about commercial-property losses and debts coming due on commercial property.

"Another problem they sought to resolve was that banks and their examiners weren't always on the same page. In some cases banks weren't recognizing loan problems, while in other cases, tough bank examiners were forcing banks to downgrade loans the bankers still believed were good.

"The guidance was intended 'to promote both prudent commercial real-estate loan work-outs by banks and balanced and consistent reviews of these loans by the supervisory agencies,' said Elizabeth Duke, a Federal Reserve governor, in a March speech. The guidelines came from the Federal Financial Institutions Examination Council, which includes the Fed, the FDIC and the Comptroller of the Currency.

"Although one goal was greater consistency in the treatment of commercial real estate loans, in practice, the guidelines appear to have fed confusion in the markets about how banks are dealing with commercial debt. 'I just don't believe that the standard is being applied consistently across the industry,' says Ed Wehmer, chief executive of Wintrust Financial Corp. in Lake Forest, Ill.

"In a May conference call with 1,400 bank executives, regulators sought to clear up confusion. 'We don't want banks to pretend and extend,' Sabeth Siddique, Federal Reserve assistant director of credit risk, said on the call. 'We did hear from investors and some bankers interpreting this guidance as a form of forbearance, and let me assure you it's not.'

"Still, restructuring increased at some banks, like BB&T Corp. of Winston-Salem, NC. It reported in April that it had restructured $969 million of commercial loans, largely on property, in recent months to help customers ride out the economic slump. That was a huge jump from six months earlier, when the figure was just $68 million.

"The increase was basically a function of implementing the new regulatory guidance,' the bank's finance chief, Daryl Bible, told investors in May. 'We are working with our customers trying to keep them in the loans.'

"BB&T's report showed a significant number of cases where it was extending loan maturities and allowing interest rates not widely available in the market for loans of similar risk.

"Banks don't have to disclose how terms on their loans have changed, making it hard to know whether they are setting aside enough cash for possible losses.

"In an increasing proportion of cases, modifying the terms of loans intimately isn't enough to save them. At the end of the first quarter, 44.5% of debt restructurings were 30 days or more delinquent or weren't accruing interest, up from 28% the first quarter of 2008….

"A case in Portland, Ore., shows how banks can keep treating a commercial loan as current, despite the difficulties of the underlying project.

"A client called Touchmark Living Centers Inc., in 2007 borrowed $15.9 million, in two loans, to buy land for a development. The borrower planned to retire the loans at the end of the year by obtaining construction financing to build the Touchstone Heights community for empty-nesters.

"Because the raw land produced no income, the lender, Umpqua Bank, had provided 'interest reserves' with which the developer could cover interest payments while obtaining permits and preparing to build. The bank extended Touchmark a $350,000 interest reserve – in effect increasing what Touchmark owed by that amount.

"In December 2007, the US economy slipped into recession. When the loans came due that month, Touchmark didn't pay them off. Umpqua extended the maturity to May 31, 2008.

"The bank also added $600,000 to the interest reserves. Though supplying interest reserves is common at the outset of a loan, when an unbuilt project can't produce any income with which to pay debt service, replenishing interest reserves when the borrower can't pay is frowned upon by regulators.

"Asked to comment, a spokeswoman for the bank said, 'Umpqua and Touchmark had determined that the project was still viable but not yet ready for development.' Touchmark said it didn't pursue construction financing at that time because 'it was not prudent to proceed with developing the property until the economy improves,' as a spokesman put it.

"In 2008 the bank extended the loans again, to April 2009. During this time, Touchmark began paying interest on the loans out of its own pocket.

"Then in May 2009, Umpqua restructured the loans, lumping what was owed into one $15 million loan that required regular payments on both interest and principal. Touchmark paid down the principal a little and Umpqua set a new maturity date – May 5, 2012.

"Meanwhile the value of the land Touchmark had borrowed to purchase has been eroding. The banks says it was worth $23.5 million by the most recent independent appraisal, but that was in 2008. The county assessment department pegged the land's value at about $20 million at the start of 2009. An appraiser for the department estimates raw-land values in the area fell by another 25% to 30% last year.

"Touchmark executives declined to estimate the land's value. They said the property has retained 'significant' value, partly because of its location, with a view of 11,240-foot Mount Hood."

At least the mountains created by the Good Lord can be readily appraised for height and firmness.

No Such Certainty for Banks' Debt

It is certainly no consolation that the government that ignores its investment in human value, which was recognized to be the most rewarding investment a government can make has been forgotten. That most important investment instead of an asset is treated as a debt, which means that the finances of our governments have been manipulated to the point where they are as hopeless as the finances of Touchmark – Umpqua.

This is an incredible state of affairs for governments that have committed themselves to mining non-polluting hydrocarbons on a moon of the outlying planet Saturn. And the government will apparently be relying on personnel that couldn't get to see the inside of a university, because our governments were intent on balancing their books without anything that could be mistaken for accountancy – even in the darkness of the power failures in our great metropoles.

W.K.

On the Freedom of Courts

The New York Times Magazine (27/06, "What a Liberal Court Should Be" by Noah Feldman) presents a background sketch of the efforts of the US Supreme Court to block or catch up with whatever efforts the legislatures may have been engaged in. This is particularly relevant in these bewitching times. Notably, the pace of change depends not only on the pace of life, but on deaths, which at times can alone create the vacancies on the Supreme Court that may be needed to make replacement appointments that would undo the judicial hold-up of legislatures that have already been dragging their feet.

The Crisis

"After decades of stagnation, progressive, constitutional thought is reaching a crisis point. Consider that the two great 'liberal' justices who retired from the Supreme Court most recently – David Souter in the spring of 2009 and John Paul Stevens a year later – were conservatives. Not only were both appointed by Republican presidents, but both subscribed loosely to the adage 'If it ain't broke, don't fix it.' With a handful of exceptions, neither favored identifying new constitutional rights where none existed before. Their status as liberals came from the fact that, as the court on which they served tilted to the right, they held their ground as moderate Republicans, consistently voting to sustain the constitutional rights that were discovered by the Supreme Court before they were on it. To be sure, without their votes, the liberal constitutional legacy of the period stretching roughly from Brown v. Board of Education in 1954 to Roe v. Wade in 1973 would have been reversed. But Souter and Stevens were not independent forces for progressive changes in American life.

"To a great extent, the crisis of liberal thought on the Supreme Court is a result of liberalism's success. From the time that Franklin Roosevelt's appointments came to form a majority on the Supreme Court until the appointees of Richard Nixon and Ronald Regan came to predominate, liberal constitutional thinking had two major objectives – both of which it largely achieved. First, it sought to give bite to the 14th Amendment's promise to extend to all persons the equal protection of laws. The Brown decision voiding racial segregation in schools as unconstitutional was the most famous piece of the court's push for equality. The same ideal was almost encompassed in holdings that demanded 'one person, one vote' and – more controversially – that upheld affirmative action as consistent with the values of the Constitution."

Penumbras Formed by Emanations

"Second, the liberal Supreme Court interpreted the constitutional promise of liberty as a guarantee of individual autonomy – the freedom to make important life decisions without government interference, especially in the realms of sex and reproduction. Roe v. Wade was the culmination of this movement toward personal liberty. The court took the rubric of a right to privacy that it found in what it called the 'penumbras, formed by emanations' of various constitutional amendments and extended the right from marital contraception to abortion."

The leap to generalization recalls the achievements of the ancient Grecian Socratic school, but with the philosophers supporting themselves on broken crutches.

"Although the court has never embraced a right to die, it has in recent years, through Justice Anthony Kennedy, spoken of 'the right to define one's own concept of existence, of meaning, of the universe and of the mysteries of human life.'

"Since Roe, the majority of the most-pitched battles in the Supreme Court have concerned whether the liberal visions of equality and liberty should be reined in. Much of the time, as with the court's compromise rulings on affirmative action and partial-birth abortion, the result has been uneasy deadlock and indecisive squabbling. The most prominent exception is the issue of gay rights, which the court came late to embracing in Lawrence v. Texas in 2003 – and which – through the same-sex marriage question – remains in the court's future. It is not too much to say that its resolution (one way or another) will be the last act of the liberal constitutional revolution.

"No new progressive constitutional vision, meanwhile, has emerged from within the court.

"The only two Democratic appointments in the 42 years between Thurgood Marshall in 1967 and Sonia Sotomayor in 2009, Justices Ruth Bader Ginsburg and Stephen Breyer, reflect this reality. Ginsburg's distinguished career as a lawyer in the women's rights movement before she went on the bench embodied the drive for equality, but as a justice, she has striven, mostly successfully, to preserve what she won as a Supreme Court advocate. Breyer's own pre-judicial reputation was made as part of a bipartisan, technocratic movement for cautious deregulation; on the court he has been centrist and pragmatic, voting to preserve the liberal legacy while showing a willingness to compromise on a case-by-case basis. Neither Sotomayor nor the current nominee to the court, Elena Kagan, has articulated a new progressive constitutional vision, either.

"Why does the absence of this vision constitute a crisis for liberals? The answer is that new and pressing constitutional issues and problems loom on the horizon – and they cannot be easily solved or resolved using the now-familiar frameworks of liberty and equality. These problems cluster around the economic situation, which has revealed the extraordinary power of capital markets and business corporations in shaping the structure and actions of our government. The great economic and political challenges of our present decade – salvaging and fixing financial institutions, delivering health care, protecting the environment – have major constitutional dimensions. They require us to determine the limits of government power and the extent to which the state can impinge on collective and individual freedoms. Progressive constitutional thinkers, so skilled in arguing about social and civil rights, are out of practice in addressing such structural economic questions.

"More alarming is the fact that over the past couple of decades evident gains from deregulation have made many lawyers – progressive and conservative alike – too complacent about deferring to the markets on which our economy depends. That markets work well in many contexts has strengthened the traditional conservative argument about the constitutional duty to respect private economic transactions – even in the minds of many liberals. Civil libertarian commitments, meanwhile, have become increasingly absolute, leading some liberals to favor extending basic rights to corporations, not just to individuals. The American Civil Liberties Union, for example, has long urged the Supreme Court to treat corporations just like individuals when it comes to political speech.

"To address these challenges, however, progressive constitutional thoughts must

discover (or rediscover) a core set of beliefs about the right relationship between government, the individual and the powerful corporate entities that operate under the umbrella of the market. Re-regulation, embraced by the Obama administration to address a range of serious economic and environmental dangers, demands its own sets of constitutional explorations and explanations. A truly progressive constitutional project needs to go beyond simply upholding regulations challenged in court. It demands that the Supreme Court and other bodies acknowledge the government's responsibility to protect our democracy from the harmful side-effects of all-powerful markets."

The Past and Future of a Liberal Court

"To understand today's jurisprudential crisis, it helps to recognize that liberal constitutional thought is not a single settled body of doctrine but rather set of ideas that have evolved in response to political, social and economic challenges. Today, for instance, judicial activism is a constitutional approach mostly associated with liberals, while judicial restraint is a constitutional theory most often connected to conservatism. But liberal constitutional thought did not begin with activist-judicial expansion of equality and liberty as its main goal. It started, rather, with a near-absolute commitment to judicial restraint.

"The story begins in the years after the Civil War, as the United States industrialized. By the late 19th century, political progressives had identified a great threat to American democracy in the overwhelming capacity of business to dominate the lives of individuals and the functioning of governments. Their answer was to regulate the new industries and labor markets, in the hope of cleaning up business practices, serving consumers and getting workers real wages for reasonable hours of work. But an activist Supreme Court blocked the way. In a string of cases that, with ebb and flows, lasted from 1905 into the 1930s, the court overturned progressive laws. Its philosophy was based on a libertarian reading of the Constitution, one that emphasized inalienable rights and treated property as being inseparable from liberty.

"The case that gave its name to this constitutional era was Lochner v. New York (1905). Joseph Lochner, a baker in Utica, NY, employed a bakery workers for more than 60 hours a week allowed by a progressive New York law. The Supreme Court vindicated Lochner by striking down the New York law as an unconstitutional violation of the liberty of contract – a right that it found in the due-process clause of the 14th Amendment. Progressive critics of the Supreme Court argued that it was overstepping its bounds, engaging in judicial activism by mandating an economic philosophy that served the interests of business. Dissenting from the Lochner decision, Justice Oliver Wendell Holmes Jr. wrote that 'a Constitution is not intended to embody a particular economic theory, whether of paternalism and the organic relation of the citizen to the state or of laissez-faire.'

"With the election of FDR in 1932, the progressive critique of the Supreme Court in the Lochner area merged with what was coming to be called 'liberalism' – the rejection of socialism and corporatist fascism in favor of a regulated market capitalism. FDR threatened to pack the court with justices who would stand aside, exercise judicial restraint and allow Congress and the president to enact laws reflecting the popular will. After a full four-year term in which no justice retired, FDR got the chance to start appointing justices. Beginning in 1937, he appointed eight associate justices and elevated another to chief justice. In the main, these justices took the bench as staunch supporters of the liberal constitutional ideal of judicial restraint. 'Activism' to them was a dirty word – a cover for justices' imposing their own preferences without constitutional warrant.

"Then a funny thing happened. Little by little, the liberal majority began to realize that it had the capacity to protect minority rights and to expand individual freedom. Its members maintained the liberal constitutional orthodoxy that the court should not impose a single economic vision in the name of the Constitution. But when it came to equality and individual liberty, most of the liberal justices slowly moved away from judicial restraint, actively protecting religious and racial minorities and defending civil liberties.

"The liberal justices and their academic followers labored mightily to explain why activism in support of equality and individual liberty was consistent with the Constitution while activism in protecting the liberty of contract was not. Their efforts demanded creativity and generated much of modern constitutional thought. Justice Hugo Black, for example, came up with the theory of constitutional originalism to explain the difference: equality and individual liberty, he argued, were consonant with the text of the Constitution and the intention of its framers, but corporations should not be protected under the meaning of the word 'person' in the 14th Amendment. (For Black, originalism was a liberal theory, not the conservative one it would become decades later in the hands of Justices Antonin Scalia and Clarence Thomas.) Others, including Justice William O. Douglas, were less troubled by the abandonment of judicial restraint. For Douglas, trained as a legal realist to notice power more than principle, the court's inevitably political character justified the choice to interpret the Constitution in terms of liberty. Justice William Brennan echoed this perspective. He would ask his new law clerks what was the most important rule of constitutional law, then answer by holding up five outstretched fingers to signify the number of votes needed to form a majority of the court….

"The legal scholar John Hart Ely sought to solve the dilemma by arguing that the underlying purpose of the Constitution was to facilitate political participation; equality and individual liberty served this goal, he maintained, while property protection did not. The lawyer-philosopher Ronald Dworkin offered a theory in which fidelity to constitutional tradition must be joined to moral judgment about the results. His view, designed to explain how judges should think about the law generally, salved the consciences of liberals who believed that blocking economic regulation was morally mistaken while enhancing equality and individual liberty was morally desirable.

"Today, constitutional progressives still say that the courts should defer to economic regulation by the government. But the ideal of judicial restraint has been undercut by the selective and opportunistic way in which liberals and conservatives alike have invoked it. And conservatives have once again mastered the art of depicting corporate interest in terms of individual liberties. What is needed, therefore, is an argument about why regulating markets is, from a constitutional perspective, desirable to enhance the constitutional values of self-government and individual liberty."

W.K.

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Human Capital — Denied Even a Mention — Scores a Come-back Back Reshaping School Systems

The New York Times Magazine (05/23, "How Obama's 'Race to the Top' Could Revolutionize Public Education" by Steven Brill) examines how the concept of human capital, the greatest lesson to have come out of World War II. Though committed to society's garbage bin over a quarter of a century ago it is enjoying a regal re-entry through the front door.

We quote: "Michael Mulgrew is an affable Brooklyn vocational high school teacher who took over last year as head of New York City's United Federation of Teachers when his predecessor, Randi Weingarten, moved to Washington to run the national American Federation of Teachers. Over breakfast in March, we talked about a movement spreading across the country to hold teachers accountable by compensating, promoting or even removing them according to the results they produce in class, as measured in part by student test scores. Mulgrew's 165-page union contract takes the opposite approach. It not only specifies everything that teachers will do and will not do during a six-hour-57.5-minute workday but also requires that teachers be paid based on how long they have been on the job. Once they have been teaching for three years and judged satisfactory in a process that invariable judges all but a few of them satisfactory, they are assured lifetime tenure.

"Next to Mulgrew was his press aide, Richard Riley, 'Suppose you decide that Riley is lazy or incompetent,' I asked Mulgrew, 'Should you be able to fire him?'

"'He's not a teacher' Mulgrew responded. 'And I need to be able to pick my own person for a job like that. Then he grinned, adding: 'I know where you're going, but you don't understand. Teachers are just different.'

"That is the kind of story that makes Jon Schnur smile. Schnur, who runs a Manhattan-based school-reform group called New Leaders for New Schools, sits informally at the center of a network of self-styled reformers dedicated to overhauling public education in the US. They have been building in strength and numbers over the last two decades and now seem to be planted everywhere that counts.

"They are working in key positions in school districts and charter-school networks, legislating in state capitals, staffing city halls and statehouses for reform-minded mayors and governors, writing papers for policy groups and dispensing grants from billion-dollar philanthropists like Bill and Melinda Gates Foundation. Bill Gates, along with Education Secretary Arne Duncan, Teach for America's founder, Wendy Kopp, and the New York City schools chancellor Joel Klein could be considered the patron saint of the network."

Race to the Top

"Now, Schnur and the well-positioned fellow travelers on his speed dial have seen their cause take center stage. Why the sudden shift from long-simmering wonk debate to political front burner? Because there is now a president who, when it comes to school reform, really does seem to be a new kind of Democrat – and because of the clever idea Schnur had last year to package what might otherwise have been just another federal grant program into a media-alluring, if cheesy-sounding contest called Race to the Top. It has turned a relatively modest federal program (the $4.3 billion budget represents less than 1% of all federal, state, and local education spending) into high-yield leverage that could end up overshadowing health care reform in its impact and that is already upending traditional Democratic Party politics. The activity set off by the contest has enabled Schnur's network to press as never before its frontal challenge to the teachers' unions: they argue that a country that spends more per pupil than any other but whose student performance ranks in the bottom third among developed nations isn't failing its children for lack of resources but for lack of trained, motivated teachers accountable at the front of the class."

What is involved is the that key importance of investment in "human capital." This, without doubt, was the most important lesson to come out of WWII – the unique importance of human capital which was proven to be the most important investment a government can make. Without it governments will bumble along without anything that can be considered serious accountancy. For most important investment a government can make is treated by governments not as capital assets but as "spending" leading to debt, which is met with higher interest rates. We need not apologize for repeating this vital bit suppressed history, accountancy, and economic theory, because – we would be delighted to be corrected – but to the best of our knowledge, we are the only organization that keeps this crucial compass of world economy to tell us where we have come from and where we are headed. Certainly *The New York Times* has the story in its files, but doesn't dare use it. However, be it noted without the realization of our human capital investment, the better-educated Americans who will certainly emerge from the Race to the Top strategy of Mr. Obama and Mr. Schnur will provide inadequate employment for the greater number of better-educated graduated from American educational institutions. That will not contribute to a happier society, or to one that can keep the world out of the ultimate of desperate gambles – atomic war.

Returning to the Steven Brill article: "Schnur, who is 44, became interested in education when as an editor of his high-school newspaper, he read a draft of an article of a student who had transferred from a Milwaukee public school to his school in the suburbs. 'She was savvier than any of us on the editorial board, but the draft was just so terribly written,' he told me. Schnur added that 'the more I got to know her, the more I became obsessed with public education hadn't reached people like her.' After graduating from Princeton, he worked in the Clinton campaign and then landed an education policy job in the Clinton administration.

"Schnur recalls that when he met Barack Obama before his Senate campaign in 2004, and heard him talk about education. 'I figured this guy could be the great education president – in 2017.' When Obama moved up the timetable, Schnur joined his 2008 campaign as a policy adviser. Six months later, he was working as a counselor to education secretary stimulus program, Duncan and Schnur diverted $4.3 billion to the contest aimed at encouraging cash-strapped states to overhaul their public schools. Schnur came up with the name and pushed the overall spin of the contest, and it was clear from the conversations with people in the school-reform movement that he is the one person who seems to know

everything happening on all fronts from the White House to legislative chambers in Albany or Sacramento to charter schools in New Orleans.

"The winners of the Race would be those states that submitted the best blueprints for fulfilling the reform agenda, which includes allowing school districts to take over failing schools, improving curriculum standards, and encouraging school innovations (which means, in part, allowing charter schools to flourish). But what the reformers have come to believe matters most is good teachers.

"'It's all about talent,' Secretary Duncan told me. Thus, the highest number of points – 138 of the 500-point scale that Duncan and his staff created for the Race – would be awarded based in a commitment to eliminate what teachers' union leaders consider the most important protections enjoyed by their members: seniority-based compensation and permanent job security. To win the contest, the states had to present new laws, contracts and data systems making teachers individually responsible for what their students achieve, and demonstrating, for example that budget-forced teacher layoffs will be based on the quality of the teacher, not simply on seniority."

The Ever-suppressed but Ever-recurring Issue of Human Capital

So what we have here is a further repetition of the key importance of investment in human capital, which today is not only being ignored as "the most important investment a government can make," but is being treated as a debt, justifying higher interest rates and slashing expenditures on education, health, the environment, and proper retirement funds when needed for our aging population.

But back to the basic expunging of this most crucial bit of our history. At the end of WWII, Washington sent many hundreds of economists to Japan and Germany to assess the damage done to these leading Axis powers, and foretell how long it would take for them to become again leading exporters in the world economy. Some sixteen years later, one of these, Theodore Schultz, published a book explaining why he and his colleagues were so wrong in their forecasts. He concluded that they were misled by concentrating on the physical destruction, but lending scant importance to the fact that the highly educated work-force had come out of the war almost intact. And with a stroke of genius, from this he concluded that human capital was the most productive investment a government could make. That included, of course, expenditures not only for education, but for health the environment, and for the retirement of a much longer-lived population.[1]

Treated in this way for what it really was, investment in human capital was not only prepaid, but its expenditure had many of the features of further investment. Children of better educated parents are more readily educated, healthier, and thus share many of the features of a further investment. Britain is still drawing revenue from was spent to educate Shakespeare or Newton.

For a few years Schultz was celebrated, decorated and then completely forgotten. We are sorry to state that to the best of our knowledge, COMER is the only organization that remembers the great man and his teachings. Yet *The New York Times* will have more in its files than we have, but never mentions the name. Contrast the very great freedom for ideas that existed during the Great Depression of the 1930s. At least speculative banking has learned some deep lessons from the 1930s to defend its quite indefensible interests.

"Fifteen states, including New York and California, now operate under union-backed state laws mandating that seniority or 'last in/ first out,' of teachers, like those recruited by Teach for America, determines layoffs. These quality-blind layoffs could force a new generation of teachers out of classrooms. To enable teacher evaluations, another 47 points would be allocated based on the quality of a states 'data systems' for tracking student performance in all grade – a euphemism for the kind of full-bore testing regime that makes many parents and children cringe but that the reformers argue is necessary for any serious attempt to track down not only student progress but also teacher effectiveness.

"By late March, when the first round of the Race ended, it was clear that Schnur's spin had worked 'better than any of us imagined,' he says. Thousands of local news stories across the country speculated about how particular states were faring, some of them breathlessly referring to the 'March Madness' as governors, state legislators and bureaucrats rushed to consider reforms that might improve their chances…. Before Duncan had dispensed a nickel, the country had seen more school reform than it had in decades….

"When the starting fun for the Race went off, four forces that had been building came together and gained strength from one another.

"First there's the rise of the reformers who seem to be in daily communication through e-mail and blogs. The standard profile is someone who went to a prestige college, joined Teach America for a two-year stint and found the work and the challenges so compelling that he or she decided education should be more than a layover before a real career.

"So they did more teaching or became involved running a charter school or a reform group, then kept moving up the ladder as sympathetic political leaders…took over cities or states and looked for people to overhaul school systems.

"Although Schnur is a cheerful, modest type, there is a strain of self-righteousness that runs through the reform network. Some come off as snobs who assume any union teacher is lazy or incompetent and could be bested by young, non-union Ivy Leaguers full of energy. And others see tying teachers' pay to their students' improvement on standardized tests as a cure-all. But most – especially those who have taught and appreciate how hard that is – understand that standardized tests are far from perfect, and that some subjects like the arts, don't lend themselves to standardized testing. They know that most teachers want to be effective and that data-based performance assessments should be combined with classroom observation and other subjective measures not only to hold teachers accountable but to help them improve their performance.

"The second force at work is a new crop of Democratic politicians across the country – including President Obama – who seem willing to challenge the teachers' unions.

"Third, there's the boost given to school reform by high-powered foundations, like the Gates Foundation, which have financed important research and pilot reform projects, and by wealthy entrepreneurs, who have poured seed money into charter schools.

"And fourth, there's the charter-school movement, which has yielded an increasingly large and vocal constituency of parents whose children are among the more than 1.5 million students attending more than 5,000 charter schools.

"If unions are the Democratic Party's base, then teacher's union are the base of the base. The two national teachers' unions – the American Federation of Teachers and the larger National Education Association – together have more than 4.6 million members. That is roughly a quarter of all the union members in the country…. In the last

30 years, the teachers' unions have contributed nearly $57.4 million to federal campaigns, an amount about 30% higher than any single corporation or other union. And they have contributed many times more to state and local candidates. About 95% of this has gone to Democrats.

"Before they successfully organized in the 1950s and 1960s, teachers endured meager salaries, political favoritism, tyrannical principals, and sex discrimination against a mostly female work force. It's that sense of needing to stick together against real or potential mistreatment by management, plus a sincere – and accurate – belief that most teachers do teach for reasons beyond simply making a living, that drives Mulgrew and other union leaders.

"Nonetheless, almost all the states that submitted first-round applications proposed reforms that a year ago would have been seen as pushing beyond what the teachers' unions would allow. Some moved farther than others because the lure of the Race to the Top money trumped the others' opposition. Or because political leaders and educators were able to persuade union leaders to get on the train instead of standing in front of it."

However that may be, the essay of Steven Brill has delivered us in quite regal style to where we desired going, needing only to add a crucial fifth to the "four forces" that had been building up gaining strength from one another.

That fifth factor – banished as unfit to even refer to is however so powerful, that it would cause to vanish all the perverse mountain-high accumulation of debt that those in charge of humanity's further fate bow down before and worship.

We have already alluded to it in our present article, but we need the evidence of Steven Brill's essay to provide a context that has flattened the walls of prejudice that the regime of speculative banks have thrown up against the most powerful lesson that came out of World War II. That is the proof that "the most powerful investment that a government can make, is in human capital." To begin with that investment is prepaid and should therefore appear on the government's books not as a debt but as an investment – with the greatest return that a government can make. Recognize that, and it will no long be necessary to slash government budgets. On the contrary, it is one of the very unique characteristics of investment in human capital in this era of urbanization, high technology, stress on our environment all require stepped up education and research not slashed budgets and growing unemployment. Without this our world, rather than being headed for disaster, would be free to retrain our unemployed, build, new schools and universities. Require of our universities the latent promise of their name – institutions where all scientific disciplines mingle and seek out common territory where humanity may thrive.

Our central bank – the Bank of Canada still contains the provisions – most cavalierly ignored – that allows our federal government to finance its capital requirements at near-zero costs. There is also provision for financing the needs of provincial and municipal governments with the BoC's resulting revenue going to the federal government that will no longer feel the need of unloading much of its ill-considered debt on the lower levels of government.

It will no longer be deemed necessary to pay off the debt, because that debt will no longer be represented as a debt but recognized once again as a prepaid investment in human capital.

This and the revival of employment, will provide buyers for the foreclosed homes able to afford them. That will revive the market for those who stand in need of housing and will have the employment that will make it possible for them to carry them.

Nobody who served previous regimes that wiped out the very notion of human capital will be allowed to continue at a crucial policy-determining level of government. The literature of economic theory down the ages will be curriculum in economic courses.

The phenomenon of rising price levels must no longer be confounded with inflation, which properly refers to prices rising because of a lack of available supply to satisfy existing demand. Prices may go up for very different reasons – for example, an increase in non-marketed goods and services required by the government. That could be referred to as the "social lien" and the two, should never, ever be confounded.

Nobody at the policy-making government level associated with the present disastrous policies must be permitted to continue in government service. A series of perceptive economists and economic historians have dealt with the obstruction to new desirable policies that will ensue if this warning is not heeded. François Perroux has enlarged helpfully on this point.

William Krehm

1. Schultz, Theodore W. (1971). Investment in Human Capital. In Kiker, B.F. (Ed.), *Human Capital*, p. 14. Columbia: University of South Carolina Press.

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Sequel to New York Times Magazine Article, "What a Liberal Court Should Be"

June 21, 2010, by Noah Feldman

We interrupted the magnificent piece of Mr. Feldman not because we had had enough of it, but because he dealt not with just individual laws. Instead, he has come up with a method that extends a legal argument to encompass the actual human problems that are herding our very civilization to its ruin.

For example, we celebrate the memory of those our troops who never came back from World War II. Surely that could serve as a good legal reason to dust off the greatest lesson to come out of that conflict, but has since been buried to serve the interest of our speculative banks. We have need of his notion of finding adequate legal cause to reveal the duty of governments to find legal arguments that protect the interests of the mass of citizens. And certainly the notion of investment of human capital fits that need like a glove.

At the end of World War II Washington sent many hundreds of economists to Japan and Germany to study the wartime destruction to forecast how long it would be before those two mighty trading nations could become that again. Some sixteen years later one of these, Theodore Schultz of the University of Chicago, published a book that explained how wrong he and his colleagues had been in their forecast. It was because, said he, they had concentrated on the physical destruction, but paid little heed to the detail that their highly talented, skilled, and motivated work-forces had come out of the conflict almost intact.

And to leave no doubt about the value of that human capital, the Japanese rebuilt their smashed and burned-out economy along radically new lines. Instead of a textile-exporting economy that had to import its raw materials, leaving a minimum of profit in their land, the Japanese step by step went about building a completely new type of economy based on heavy equipment economy that would far greater portion of their sale volume in Japan. From that and what happened in Germany Schultz concluded that human capital was the most profitable. investment a government could make. For his great achievement, Schultz was feted, decorated with a Bank of Sweden Nobel prize, and then completely forgotten.

That is because our deregulated speculative banks find it far more profitable to ignore the investment in human capital, and show a great debit that will drive up interest rates – the battering ram used by them to reduce the economies to supposedly bankrupt debtors.

There is this about human capital: it is not only prepaid, but its very expenditure has the characteristic of reinvestment. The children of educated parents are easier to educate, and healthier, and better adjusted than those of most uneducated parents. Ours is a rapidly urbanizing economy on practically all continents. That not only calls for physical infrastructures such as subways, highways, schools, but there could be readily structured investment plans that would leave the governments with much of the capital enhancement that results from such infrastructure. Today these facilities are sold or rented to international financial interests that waste no time in raising tariffs. All this arrant waste could be reversed to make for a healthier, more prosperous, better-educated population in a better preserved environment.

The Need for a Progressive Jurisprudence

The key to it all is Feldman-like projects to identify the progressive jurisprudence of that will protect the interests of our citizens.

But the very dependence of our civilization on its fund of human capital, means that our Supreme Court be alerted to seek out the jurisprudence that will protect the interests of our citizens.

That, however, will require enough familiarity with other disciplines – including not only what passes for economic science today, but the more rewarding resources available from historians, sociologists and even the teachings of great economists whose very names have been suppressed today. Fortunately, we do have our universities, whose very name reminds us of a time when all disciplines and departments of learning come into contact with one another. That, however, is no longer so. Economics department has been cleansed of all influences that might cast doubt on the self-balancing market, and the alleged need of what is currently called "zero inflation."

In the budgets of universities, government investment in human capital – such as education, health care, preservation of the environment, is treated as a burden of debt rather than an already prepaid investment of human capital. Yet a few decades ago such human capital had been recognized as the most rewarding investment a government can make.

In order to make possible the development of the progressive jurisprudence that Mr. Feldman has identified as necessary, I will identify just a couple of tasks that jurisprudence will have to handle.

The administration of a chosen university for the research will have to provide authorization for what is considered unorthodox enquiries in most universities throughout the world has been forbidden under penalty of early retirement. So some temporary freedom will have to be arranged. But since we are dealing with jurisprudential research sponsored by the Supreme Court, we must assumed that this can be arranged.

I will mention only a very view simple investigations.

With the cooperation of an academic from the department of philosophy the principle to be tested would be: a simple proposition cannot be turned around and considered still valid. Example: if I shoot myself in the head, I fall dead. But it cannot be considered necessarily true when turned around. If I fall dead, it cannot be concluded that I suicided. It could have been heart-failure or any of many other causes.

With this example in mind, let us return to economics. If there is an excess of solvent demand for a marketed item the price will go up. And that, can be defined as "inflation." However, prices can go up for very different reasons than a lack of market supply to meet demand. It may be that more of the national product is simply not marketed but purchased by the government and paid by taxation. This is a non-marketed area of the economy. In the late 1960s I identified it and called it the "social lien" and sent out the manuscript to some 30 technical economics publications throughout the world. It was purchased by what was then the leading French economical publication, *La Revue économique*. The reason was that

on its editorial board were two statisticians who had noted the discrepancy between the behavior of prices and the excess of market demand, and had reached the conclusion that there was another factor still not recognized involved. At which point my unsolicited essay arrived and was published in their May 1970 issue. The economic journal at Cambridge reviewed the essay most favorably and congratulated me on the name I had chosen for the phenomenon – the "social lien." It was well-received in more than a half dozen other economic journals throughout the world.

Now, when two similar effects turn out to have different causes, in any science worthy of the name, they would be given distinct names to identify their different causes. In the case of the social lien that was not done. Surely that means a door not only slammed, and locked for future researchers. It would be helpful for universities to have specialists from their departments of logic, philosophy or mathematics investigate the obstructive method of economics department in handling the issue.

Then there is the matter of insurance. Instead of appraising investments bought or guaranteed by banks, must examine what can and what cannot be insured. You can insure against risk. Premiums will go up if what you are insuring against is very risky, but if it is not *risky* but *wrong*, it is not insurable. 2 + 2 = 7 is not risky. It is wrong. Take out insurance against that and insurer and the insured or even both will go broke. Why was that distinction not made in the collateralized debt mortgage crisis that brought on so much of the present crisis?

For comment from the mathematics department. To solve an equation of the first order in two variables you need two different equations. Then as we all learned in the first week of the first year of our high school algebra class, we eliminate one variable by multiplying one of the equations so that the coordinate of the two in the equations is the same, and you have solved the problem. If there are three variables in equations of the first degree, you need three equations to solve it, two won't do it. If there are 10 million independent equations in our globalized world, you need that number of equations. How could we possibly begin even kidding ourselves that they can be solved with two variables – supply and demand.

These few simple examples will show the importance of Noah Feldman's concept of what progressive jurisprudence must be.

William Krehm

A BIT OF HISTORY

A Letter to Someone Who Can't Understand What Happened to Us

As I recollect, having been a male factory worker in a "traditional occupation" from about 1965 to 1989, it was not a case of what male workers demanded or didn't demand. They/we had the ground shot out from under us. The first wave of the bankers assault happened in 1981 when Fed Chairman Paul Volker (he's back with the Obama bailout operation) and BoC governor Gerald Bouey created a massive but fairly short lived recession by jacking interest rates to over 20%. The Inglis factory down on the Lakeshore (producing washers, dryers and dishwashers) where I was working at the time, within a month or so was on a three-day work week. (At least half of the work force in the Inglis plant at the time were women by the way, and some had been there since WWII.)

The interest rates stayed quite high throughout the eighties and only came down near the end. This kind of regime steadily undermined traditional manufacturing industry. I remember seeing statistics on different pages of the same issue of *The Globe and Mail* in the mid eighties, talking on the one hand about a panic on the Tokyo stock exchange because interest rates there had just been jacked from 3.5% to 3.75% while in Canada interest rate declined slightly from about 12.4% to 12.2%. I even pointed this out to the president of the union local at the time – but got no reaction and he was a radical. Combine these usurious interest rates with the fact that the banks would nearly always lend to a large foreign firm to buy out a Canadian firm but usually would not lend as readily to local entrepreneurs to expand and you get the picture. The banks as they say, are risk averse. Unless it involves large bonuses for their managers.

In any case the next hammer blows came in 1989. BoC governor John Crow cranked our interest rates back through the roof to get "0%" inflation precipitating the recession of the '90s (deepest and longest since the 1930s) while the Free Trade Agreement came into force through a massive serious of changes in Canadian law. Caught between the two local industry and it's workers were toast.

At the end of 1989 the Inglis plant closed its doors putting a lot of fairly well-paid men and women out of work. Around that time I watched the Chevy van plant on the Golden Mile go down, Canada Wire & Cable in Leaside, Phillips Cable in Scarborough, Sunbeam electric and Goodyear Tire & Rubber in Etobicoke, Federal Nut and Bolt in the west end – and the list could go on for quite a while. Massey Ferguson Farm machinery on King Street and Brantford had already been run into the ground by Conrad Black. Along with all these closings went support operation like Bathurst Tool and Die. That's only what I knew about from having worked in some of these places or heard about from others who worked in them directly, as well as seeing these factories flattened to make way for condos and shopping malls.

After the recession of the '90s almost none of that came back. After that it was real estate development, banking and Burger King all sustained by unprocessed natural resource sales and immigration to fill the houses and fill the jobs that a lot of those ex-factory workers didn't have the stomach for – or in many cases the training. The only thing that survived was auto and auto parts and for a time computer software development and support. Now those are nearly gone too.

Neither the men nor the women knew what hit them and their union "leadership" along with most of the NDP were asleep at the switch. These issues were all raised by the Waffle movement of the NDP at the beginning of the seventies. This was the last significant left nationalist opposition movement to hit the national stage and whole process of foreign corporate and bank takeover was only beginning then. The NDP brass moved to kill the Waffle. But the rest of the left didn't do it much good either. They were ahead of their time and we really didn't know what we were doing.

This is only one part of the history that brought us to the current mess. But it's a critical part. Without our history we are mentally defenceless, and if you didn't live through it and participate at the time you have no way of knowing it. At least not without investing a huge research effort and having the collaboration of people who did live through it – and paid attention. Because no institution teaches this.

Stewart Sinclair

With the G20 Out of Town, Our Governments Resume Groping

The Wall Street Journal (1/06, "Dow Slides 10% in a Volatile Quarter" by Tom Lauricella) sums up the situation for us: "Volatility returned to global financial markets with a vengeance in the second quarter sending investors fleeing from stocks worldwide and driving them into defensive investments, especially US Treasurys and gold.

"With the Dow Jones Industrial Average closing out the quarter at a new low for the year, the turn of events marks a sharp reversal in the 'risk' rally that began last March, and the escalation of the tumult bears resemblance to the path of the 2008 financial crisis.

"Now, the question dominating financial markets is how much longer the renewed bout of heightened fear will last?

"'A huge amount of confidence was pulled out of the markets during this period,' says John Brynjolfsson, investment chief of the hedge fund Armored Wolf.

"The Dow ended the second quarter down 1,082.61 points, or 10%, its first quarter drop since the first three months of 2009.

"The challenge for investors is that the worries run the gamut of economic, fiscal and regulatory issues – none of which are likely to be resolved overnight. Such 'macro' issues have pushed to the background 'micro' positions, mainly continued good news from US corporate earnings."

Let us stop right there to note that "macro" and "micro" don't *define* or *qualify*, they just *quantify*. Yet without adequate qualifying or definition, there can be no meaningful quantifying.

"Against this backdrop, investors have hunkered down. They are waiting to see clear evidence that a recent bout of softer-then-expected economic news in the US isn't the precursor to a double-dip recession. In particular, investors will be looking for renewed private-sector job growth to pick up the slack as government stimulus efforts wind down.

"Investors also want reassurance that the global financial system isn't again in danger, this time as a result of the sovereign-debt crisis in Europe. Key to that is seeing improvement in the inter-bank lending market in Europe, where the banks have grown wary of lending to one another.

"'It's a "show-me" market,' says Robert Doll, chief equity strategist at BlackRock Inc.

"'Fresh in everybody's mind is the carnage of late 2008 and early 2009,' he says. 'Therefore, their mentality is set to sell first, ask questions later and be content with earning 3% on 10-year Treasurys.'

"On the quarter's final day, the Dow slumped into the closing bell, losing 96.28 points, or 1%. That left it 12.8% below its 2010 high set on April 26 – placing it firmly in a correction. The Dow is 31% below its record close of 14,164.53 from October 2007 but up 49.3% from its low of 6,547.05 hit on March 9, 2009…."

A Flight to Non-existent Safe Havens

"Meanwhile, investors flocked to investments seen as safe havens. Gold rose 11.9 a troy ounce to $1,245.50, finishing the quarter just shy of its record high of $1,245.50 Treasury prices also rose sharply, driving the yield significantly lower. The yield on the US Treasury 10-year note finished at 2.96%, down from 3.84% at the end of March and making treasurys one of the best-performing asset classes for the quarter.

"The seeds of the second-quarter turmoil were planted in the first quarter as the Greek debt crisis began stirring. But as the second quarter got under way investors viewed the problems in Europe as contained.

"In late April, the Dow rallied to 11,204.28 and the S&P 500 reached 1,217.28, their highest levels since the week that Lehman Brothers filed for bankruptcy in September 2008. Reflecting that comfortable outlook, the Chicago Board Option Exchange VIX, a measure of the S&P 500's volatility known as the 'fear gauge' collapsed to readings below 15, its lowest since 2007.

"As the quarter progressed, the situation in Greece deteriorated rapidly and worry about 'contagion' – the idea that the crisis would spread far beyond its roots – reared its head and slammed stock and bond markets in other debt-laden European countries."

We need only interject at this point that the European Union – the product of a rightist DeGauliste French government – has little in common with the nationalized central banks of Canada or partially nationalized banking system such as the US Fed. Rather than allowing the central government as in Canada to borrow from its central bank at a purely nominal rate – a facility hardly used in recent years – the European Union central bank charges the member nation full interest even when they are able to get financing from the EU central bank. This results in conversations between the central bank of the EU and other central banks of major countries resembling a conversation between the deaf and the blind.

But resuming the *WSJ's* report: "At the same time, some investors grew worried that China, in an effort to slow its booming economy, will end up slamming on the brakes too hard, and derail a key global growth engine.

"As if that wasn't enough, the May 6 'flash crash,' when the Dow plunged 700 points in just eight minutes, raised concerns about the soundness of the day-to-day workings of the US stock market.

"With investors facing a laundry list of macroeconomic woes, the response has been an exodus from riskier investments that rode the initial wave of optimism about a global recovery starting last March.

"Showing the renewed tumult, the VIX fear gauge jumped back to finish the quarter at 34.54. But more than just stock took big hits from the selling. Copper, a key industrial commodity, lost 17% during the quarter and oil fell 0.7% to $78.63 a barrel.

"In the bond market, the gap between investment-grade bonds and US Treasurys rose to more than 2 percentage points from 1.5 in late April, according to Bank of America Merrill Lynch indexes. Junk bonds saw their biggest rally in history come to an abrupt end, with spreads over Treasurys jumping to more than 7 percentage points to more than 7 percentage points from around 5.5.

"For stock investors, these big picture concerns have all but erased the glow from good earnings news. 'We had hoped 2010 would be back to stock picking, but so far that's not the case,' BlackRock's Mr. Doll says.

"Michael O'Rourke, strategist at brokerage firm BTIG, says that on a micro level, stocks look attractive for long-term investors willing to brave the volatility and uncertainty.

"The stocks in the S&P 500 are trading at a price/earnings ratio of about 13.5 times 2010 estimates compared to a historical average P/E around 16, Mr. O'Rourke says.

"Conversely, he notes, US treasurys are extremely expensive by a widely watched measure. Usually, 10-year note yields are roughly comparable to the dividend yield on the S&P. Instead, the S&P is yielding more than 7% while yield of the 10-year [bond] dropped below 3% in the final days of that quarter. 'On that basis, equities are much more attractive than treasurys,' he says.

"Until the systemic fears about a double-dip recession abate, investors seem to feel safer having the risk button on their portfolios switched off.

"In the meantime, 'whenever we get a positive number, the sentiment is likely to be 'Yeah, but we haven't seen the impact of the spring,' says Robert Sinche, chief strategist at hedge-fund manager Lilly Pond Capital Management says.

"Others argue that the systemic worries, particularly concerns about Europe's banks, will slowly fade on its own accord – assuming they don't prove founded."

That is a mountain-size assumption to make. What is missing in the official figures is simply serious accountancy. The greatest lesson to come out of World War II was that human capital was the greatest investment a government can make. The suppression of this, and the treatment of human capital as debt – which is what has been done – is in effect rolling history back to the good year 1929. With the sinister detail that none of the free searching for solutions that took place then is even permitted today. Those who usurped power are determined that such solutions must not be mentioned in our universities, schools, or press, let alone in Parliament.

That is why it must be repeated and repeated until we get back the lessons of our history again. For speculative finance is running our state as never.

So with no apologies, once again, we will recount we have been deprived of the key chapter of the story of how the world put the Depression of the 1930s behind us and built the most democratic and humane society the world has known.

As soon as World War II was over Washington sent hundred economists to Japan and Germany to study the wartime damage to predict how long it would be before these two defeated nations could regain their position as formidable word traders. Some sixteen years later, one of these economists, Theodore Schultz of the University of Chicago, published a book in which he explained how badly off the mark he and his colleagues had been. And the reason, he went on to conclude, was that they concentrated on the physical destruction of the war, and paid little heed to the fact that the highly skilled, talented and educated working force had come through the war practically intact. From his grand insight we must conclude that investment in human capital is the most productive investment a government can make.

For a few years Schultz was feted, decorated, and then forgotten. Investment in human capital must, of course, include proper care of the environment, and the health of people where that precious and most crucial investment is lodged. It would include proper investments in the physical infrastructure of these many-million-headed cities. However, they are no longer considered as investment, for government investments – both material but especially in human capital have since the 1970s come to be treated as debt.

Not only have these been prepaid but the expenditure of such human capital has aspects of capital reinvestment. The children of educated parents are more readily educated, tend to be healthier and more readily adjust to modern societies.

From 1848 to 1871 workers threw up barricades in just about every European capital, battling for labor's rights. They did not prevail. The barricades we must man today will be peaceful but determined. They are the struggle to get back our history and the most important lesson to come out of World War II.

W. Krehm

Reasons for Weeping Tears

The Wall Street Journal (25/06, "Toyoda Apologizes to Holders" by Yoshio Takahashi) has tale of how utterly our world is standing on its head: "Toyota City, Japan – Under intense scrutiny in the wake of a massive recall, the head of Toyota Motor Corp. said he had feared he would have to step down from his post, ahead of a US congressional hearing on the company's vehicle safety problems.

"'I thought I might not come back [to Japan] with this position,' President Akio Toyoda told shareholders Thursday at the company's annual general meeting here in central Japan.

"The meeting which is Mr. Toyoda's first as head of the company, kicked off with the president apologizing for the high-profile recall of more than 8.5 million vehicles in the US, Japan and other markets earlier this year due to the safety concerns.

"'We created a problem for all of our shareholders over the quality of our Toyota and Lexus brands,' he said, adding that during that period he was unable to rest, not even for a moment.

"The auto maker was widely criticized for its slow response to the safety concerns, and Mr. Toyoda was invited in February to a hearing in Washington where he was grilled about the matter by US lawmakers. The recalls led to Toyota, the world's biggest car maker by volume, paying a $16.4 million fine in the US for its failure to quickly disclose potential safety defects.

"Mr. Toyoda said at the shareholders meeting that during the first few days of his stay in the US before the February 24 hearing, he wasn't able to leave the house outside Washington. 'I just tried to laugh from the bottom of my heart once a day,' the executive said.

"The top executive also told shareholders that he decided to appear on live TV programs after the hearing because he could speak directly to US customers, though he had been reluctant to speak in public during early stages of the recall woes.

"While there weren't many serious complaints from shareholders about the quality issue, some appeared to be perturbed by how Toyota handled the issue and by the recall costs that it needed to book.

"One shareholder told Mr. Toyoda that it was inappropriate for him to have cried in meetings with US employees and other people after the hearing.

"'It was definitely not good…for the head of Japan's leading listed company to be crying in public like that,' the shareholder said.

"'I will try not to cry like that again,' Mr. Toyoda replied.

"The shareholder also said he was dissatisfied with how costs of about 200 billion yen (US$ 2.23 billion) related to the latest recalls dented the company's profits in the fiscal year ended March. Toyota returned to

profitability for the first time in two years, with a net profit of 209.46 billion yen.

"Another shareholder asked how the company will cooperate with parts makers to keep quality high. Mr. Toyoda and Shinichi Sasaki, a Toyota executive vice president, explained that the company introduced new measures after the large recalls, such as a special committee set up to oversee all operations from R&D and production to sales, to improve customer service – and quality committees established in each major region to quickly respond to complaints.

"As part of such efforts to strengthen local operations, Toyota said Thursday it appointed Didier Leroy, a managing officer of the company, and the executive vice-president of Toyota Motor Europe, as its first non-Japanese president of the European Union.

"Separately, Toyota said its vehicle-production plant in Southern China will remain idled through the weekend amid a strike at a parts supplies, but operations at the factory's two assembly lines are expected to resume as early as Monday. The unrest at the supplier – Denso (Guangzhou Nansha) Co., which is wholly owned by Denso Corp. of Japan – added to a wave of labor disputes across China in recent months."

It was only when I stopped reading the dispatches and pondered how Japan – the country that had suffered the most drastic physical destruction in WWII, but because of its outstanding deployment of its human capital, had completely restructured its policies to remake its economy from reliance on textiles, that had required it to import the raw materials and thus left smaller net profits within the country to heavy metal-working industries that involved an input of the special government recognition of human capital that it considered not as a debt, but a crucial investment. That recognition permitted – in well-planned stages – its current supremacy as automobile and heavy-machinery producer.

But why then Japan's own current chain of financial disasters? My mind chewed for a day or two on the seeming paradox and came up with the obvious answer. Stood on its head all that Japan and Schultz basing himself on the experience of Japan – even more thoroughly than that of postwar Germany, and the post-war ingenuity and strength of Japanese policy becomes transmuted into its opposite – creeping debt.

The investment in human capital, recognized as the best investment a government can make – prepaid and with features of re-investment, comes to be seen only as a debt to be paid off to provide greater speculative space for our deregulated banks. Investment becomes debt, to be paid at the expense of human capital.

And in that mad setting Japan's accounts have simply been stood on their head. There is no room in our current world, conceived as one happy hunting ground for speculative finance, for human capital.

Since the Japanese were the most successful in remaking their own and world thinking on such matters, can we hope that once again they will recoup their traditional strength in such matters and lead the world onto dry land and a measure of security once again.

Or can the West reclaim its wits and a grasp of its history to help them in the great challenge on which the future of society depends?

William Krehm

Balancing the Books has Come to Mean No Accountancy

Economic sages have warned that when you are trying to replace a bankrupt economic system, you must avoid putting the change in the hands of a leader of the system being replaced. And for having ignored that, the United States is in deep trouble.

Elsewhere in this and previous issues of *ER* we have told how human capital in this age of high technology on this planet, but on our moon and a moon of a far outlying planet, sources of essential minerals are being tracked down and their exploitation being designed in quantities and chemistries unknown on the Earth. Obviously, this requires a highly educated population of scientists and engineers, that the United States does not have. Moreover, due to the misconceived notion of how budgets can be balanced by deliberately shutting their minds to what money and accounting might be about.

There are no lack of school teachers and university professors, and many schools are bring closed down. Supposedly, to balance the budget. But human capital was recognized as early as 1961 as the most productive investment a government can make.

But as we explain elsewhere in this issue, the United States has not in peacetime retained the human capital that Japan and Germany managed to, even after having lost a world war.

First we must include a word on what a balanced budget could possibly mean in an age like ours. When gold is no longer money, only the credit of the central government serves that purpose. Under F.D. Roosevelt, the *Glass-Steagall* law was brought in that prevented commercial banks from taking over for their own investments the other "financial non-banking pillars": stock brokerages, insurance and mortgage companies.

The reason for that law: When a speculative mega-bank takes over such non-banking pillars, it makes a bee-line for the cash reserves they hold for their own businesses and use it as the cash base for creating its own credit. That procedure it applies over and over again until it gets into serious trouble.

The might of the speculative banks depended on their power to manipulate interest rates, both lowering them as ploy to entice the unwary to burden themselves with debt, and then raising the rates to serve as a battering ram to dispossess them of their firms and their homes.

To restrain this destructive power of interest rates, the statutory reserves had been devised. These required the banks to deposit with the central bank a portion of their capital, on which they earned no interest. To cool off an overheated economy the statutory reserves merely had to be raised, leaving the banks with less capital to gamble. These dulled the killer-edge that interest rates would have as the sole pacemaker of the economy. Unfortunately, getting rid of the statutory reserves, first by disregarding them and then by their outright repeal, left the economy wholly at the mercy of the speculative mega-banks.

And that, if fact, is where the present crisis grew and expanded until it got the world into its current trouble.

Now a word on what paying off or paying down the debt means under these circumstances.

Part of what is called the government debt in the world today is in fact the money supply, which is neither gold nor silver, but only the credit and credibility of government. The rest is human capital – recognized a half-century ago as the best investment a government can make.

W.K.

Running a Globalized Economy without Accountancy

The New York Times (02/07, "Jobs Go Begging as Gap is Exposed in Worker Skills" by Motoko Rich) recounts a sordid tale: "Bedford, Ohio – Factory owners have been adding jobs slowly but steadily since the beginning of the year, giving a lift to the fragile economic recovery. And because they laid off so many workers – more than two million since the end of 2007 – manufacturers now have a vast pool of people to choose from.

"Yet some of these employers complain that they cannot fill their openings.

"Plenty of people are applying for the jobs. The problem, the companies say, is a mismatch between the kind of skilled workers needed and the ranks of the unemployed.

"Economists expect that Friday's government employment report will show that manufacturers continued adding workers last month, although the overall picture is likely to be bleak. With the government dismissing census workers, more jobs may have been cut than added in June.

"And concerns are growing that the recovery could be teetering, with some fresh signs of softer demand this week. A central index of consumer confidence dropped sharply in June, while auto sales declined from the previous month.

"Pending home sales plunged by 30% in May from April as tax credits for home buyers expired. Fretting that global growth is slowing, investors have driven stock indexes in the United States down to their levels of last October, for losses as great as 8% for 2010.

"As unlikely as it would seem against this backdrop, manufacturers appear to have accelerated the long-term move toward greater automation, laying off more of their lowest-skilled workers and replacing them with cheaper labor from abroad.

"Now they are looking to hire people who can operate sophisticated computerized machinery, follow complex blueprints and demonstrate higher math proficiency than previously required for the typical assembly line worker.

"Makers of innovative products like the advanced medical devices and wind turbines are among those growing quickly and looking to hire. And they too need higher skills.

"'That's where you're seeing the pain point,' said Baiju R. Shah, chief executive of BioEnterprise, a nonprofit group in Cleveland trying to turn the region into a center for medical innovation. 'The people that are out of work just don't match the types of jobs that are here, open and growing.'

"The increasing emphasis on more advanced skills raises policy questions about how to help low-skilled job seekers being turned away at the factory doors and increasingly becoming the long-term unemployed. This week the Senate reconsidered but declined to extend unemployment benefits, after earlier extensions raised the maximum to 99 weeks.

"The Obama administration has advocated further stimulus measures, and has allocated more money for training. Still, officials say more robust job creation is the real solution."

More Job-seekers Can't Meet the Requirements for Available Jobs

"But a number of manufacturers say that even if demand surges, they will never bring back many of the lower-skilled jobs, and the training is not yet delivering the skilled employees needed.

"Here in this suburb of Cleveland, supervisors at Ben Venue Laboratories, a contract drug maker for pharmaceutical companies, have reviewed 3,600 job applications this year and found only 47 people to hire at $13 to $15 an hour, or about $31,000 a year.

"The going rate for entry-level for manufacturing workers in the area, according to Cleveland State University, is $10 to $12 an hour, but more skilled workers earn $15 to $20 an hour.

"All candidates at Ben Venue must pass a basic skills test showing they can read and understand math at a ninth-grade level. A significant portion of recent applicants failed, and the company has been disappointed by the quality of graduates from local training programs. It is now struggling to fill 100 positions.

"'You would think that in tough economic times you would have your pick of people,' said Thomas J. Murphy, chief executive of Ben Venue.

"Christina D. Romer, chair-woman of the Council of Economic Advisers, said the skills shortages reported by employers stem largely from a long-term structural shift in manufacturing, which should not be confused with the recent downturn. 'I do think that manufacturing can come back to what it was before the recession,' she said.

"Automakers, for example, have been ramping up and mainly filling slots with people laid off a year or two ago.

"Manufacturers who profess to being shorthanded say they have retooled the way they make products, calling for higher-skilled employees. 'It's not just what is being made,' said David Autor, an economist at the Massachusetts Institute of Technology, 'but to the degree that you make it at all, you make it differently.'

"In a survey last year of 779 industrial companies by the National Association of Manufacturers, the Manufacturing Institute and Deloitte, the accounting and consulting firm, 32 percent of companies reported 'moderate to serious' skills shortages. Sixty-three percent of life science companies, and 45 percent of energy firms cited such shortages.

"In the Cleveland area, historically a center of metalworking and rubber production, more than 40,000 manufacturing workers lost their jobs in the recession, a 21 percent decline, according to an analysis of employment data by Cleveland State University. Since the beginning of the year, the region has added 4,500 positions.

"Employers say they are looking for aptitude as much as specific skills. 'We are trying to find people with the right mindset and intelligence,' said Mr. Murphy.

"Ben Venue has recruited about half its new factory hires from outside the pool of former manufacturing workers. Zachary Flyer, a 32-year-old Army veteran, had been laid off from a law firm filing room when he applied at the drug maker last summer.

"He spent four months this year learning how to operate a 400-square-foot freeze dryer that helps preserve vials of medicine. Monitoring vacuum pressure and temperatures on a color-coded computer screen with flashing numbers, Mr. Flyer said last month that he preferred his new work to the law firm, where he had spent seven years.

"'I like the jobs that are more hands-on,

RENEW TODAY!
(SEE PAGE 2)

as opposed to watching paperwork all day,' he said.

"Local leaders worry that the skills shortage now will be exacerbated once baby boomers start retiring. In Ohio, officials predict that about 30 percent of the state's manufacturing workers will be eligible for retirement by 2016.

"'The new worker of tomorrow is in about sixth grade,' said John Gajewski, executive director of the advanced manufacturing, engineering and apprenticeship program at Cuyahoga Community College in downtown Cleveland. And they need training to move into manufacturing.'

"At Astro Manufacturing and Design, a maker of parts and devices for the aerospace, medical and military industries, Rich Peterson, vice-president for business development, recently gave a tour to a group of eighth graders.

"He showed off surgical simulators and torpedo parts, saying he wanted them to see the 'cool' things the company makes. By the end of the tour, more than a third of the students said they might consider working at a place like Astro, which is based in Eastlake and has five plants in the Cleveland area.

"For now, the company urgently needs six machinists to run what are known as computer numerical control – or CNC – machines. An outside recruiter has reviewed 50 resumes in the last month and came up empty. The jobs, which would pay $18 to $23 an hour, require considerable technical skill. On an afternoon last month, Christopher Derbruyker, 34, was running such a machine, the size and shape of a camper van parked on the factory floor.

"Mr. Derbruyker who has been an operator for 15 years, had programmed the machine to carve an intricate part for a flight simulator out of a block of aluminum, and he monitored its progress on a control pad with an array of buttons. 'We need 10 more people like him,' Mr. Peterson said."

By now our reader will have sensed that he is being led to what was undoubtedly the most important lesson that came out of World War II – that investment is human capital is the most rewarding to the nation that a government can make. Elsewhere in this issue of *Economic Reform* and in each previous one since the suppression of this crucial historical since WWII, has been forcefully erased from public memory even though the evidence – particularly in Canada – is still preserved in the disregarded laws of the land.

The Depression of the 1930s caught the speculative bankers who brought it on by surprise to such an extent that there was a great freedom in countries with parliamentary government to get to the bottom of the disaster. In the United States President F.D. Roosevelt, with little familiarity with economic theory, listened to anyone who had a solution to propose – whether to raise the price of gold – a complete dud of an idea – or to undertake hydro-electric projects public works financed by the government's credit and paying very modest wages. Since government credit was almost the only monetary resource left in the land – 36% of the banks of the land had already shut their doors – it was easier to declare a bank moratorium during which for a full month all banks were closed. Meanwhile Roosevelt, listened to anyone with an idea of how to get the economy moving once again.

By 1935 he was able to get through Congress the *Glass-Steagall* law, which, thank the Lord, President Obama finally deigned mention after about a year in office. That law forbade commercial banks to acquire "non-banking pillars," such as, note well, stock brokerage firms, insurance and mortgage companies. Significantly such encroachments, when *Glass-Steagall* came to be ignored in the 1980s, and finally repealed in 1998, made it possible for the banks to take over the Savings and Loans companies essentially mortgage trusts and set off the accelerating build-up of bank speculative investments, using the reserves these other "pillars" needed for their own business to serve as base for the banks own credit creation. What resulted was an accelerating elevator doomed to move ever higher at an ever accelerating clip. Until the final crash which has floored the world economy.

G20's Irresponsible Trifling

What G20 has come up with is irresponsible trifling, rather than addressing the real problem – the disregard of serious accountancy that would recognize what had been hailed as the most important lesson to come out WWII. We have recounted the great epic repeatedly, but we must go on doing until it is heeded. Today, even *The New York Times*, that has its own survival problems, leads us to the lip of the abyss, without daring to look down. For survival, it, too, must avoid alienating the leading bankers, who, significantly, like Mr. Geitner, surround President Obama in key positions.

What is never mentioned today is the name of Theodore Schultz, one of the hundreds of economists who after the defeat of Japan and Germany were sent to these two battered powers to study the wartime damage and predict how long it would take for them to become great trading nations again.

Some sixteen years later, one of these, Theodore Schultz of the University of Chi-

THANK YOU FOR YOUR SUPPORT!

Incongruity *from page 1*

um-3 per week would theoretically. provide enough safe nuclear-fusion energy to meet the entire needs of the entire world. (The only practical Earth source for Helium-3 is apparently obsolete nuclear warheads.) Russian scientists have advanced similar analysis – suggesting that lunar mining could be under way by 2020, provided governments invested $6 billion in up-front funding.

"Only Americans – 12 of them – have walked on the moon. US astronaut Harrison Schmitt, a geologist champions lunar mining of Helium-3 and puts the up-front cost at $15 billion, or (he says) roughly the cost of building the Trans-Alaska Pipeline.

"US President Barack Obama cancelled the US space shuttle program, reversing president George W. Bush's policy that NASA 'should extend a human presence across our solar system.'

"He has not, however, ended all lunar exploration. NASA will still attempt to land robotic 'prospectors' on the moon within the next four years to test technologies (in NASA's words) for 'in situ resource utilization.' In other words, for mining.

"Mr. Schmitt says that private sector investors are now prepared to do the job of mining the moon by themselves. (By some calculations, a ton of Helium-3 delivered to Earth by shuttle would be worth a billion dollars – a sum the G20 summit again immediately evokes.) But, independent of commerce, human destiny compels public investment, too. As the poet e.e. cummings once emphatically put it: 'listen: there's a hell of a good universe next door – let's go.'"

However, it should be clear from all this that you will need better-educated people than Grade 7 dropouts, no matter how brilliantly you have balanced government books that are evading serious accounting like the plague.

William Krehm

cago, published a book[1] in which he marveled how badly he and his colleagues had botched the answer.

This he attributed to their having concentrated on the physical destruction and overlooked that the superbly trained and dedicated human capital had come out of the conflict essentially intact. This caught on like wild fire, and for a few years Schultz was celebrated, decorated, and then utterly forgotten. I would love to be contradicted, but I believe that COMER is the only organization today to mentions the great economist who came up with the answer to the overriding problem that threatens to drive the world to its ultimate doom in atomic warfare.

For ignoring the investments of government in both physical and human capital, the "greatest investment a government a government can make" – along with the vast investments in physical infrastructures in a world exploding with urbanization and population increase. To that must be added the money supply which is no longer gold or silver, but government debt. With the phasing out of the statutory reserves that banks were required to leave with the central bank without receiving interest. These statutory reserves cut down the dependence on higher interest rats to deal with higher prices. But interest rates provide the raw revenue as well as the battering ram for large speculative banks to arrange and rearrange the world to their own interest.

But "fighting inflation" by allowing the large speculative banks to play games with the incomes and credit of governments and private citizens you are not only "cooking the books" but doing so in the Devil's great Hell-Fire oven.

William Krehm

1. Schultz, Theodore W. (1971). Investment in Human Capital. In Kiker, B.F. (Ed.), *Human Capital,* p. 51. Columbia: University of South Carolina Press.

GM Seeks Partners for Car Loans

The Wall Street Journal (24/06, "GM Seeks Partners for Car Loans" by Sharon Terlep) reports: "General Motors Co. is in talks with financial institutions to broaden the availability of auto loans, a strategy that for now sets aside any plans to acquire its own lending arm, people familiar with the situation said.

"The car maker has had trouble providing loans to more consumers, particularly to those with weaker credit history, and views this as a barrier to winning back US market share.

"The company is looking to become more attractive on Wall Street ahead of an initial public offering expected later this year. GM – majority-owned by the US government – plans to update stock analysis Tuesday on its finances and outlook.

"GM sold control of its GMAC LLC finance arm three years ago, making it one of the few major vehicle sellers in the US marker without an in-house lender.

"GM executives believe that entering into deals with other lenders such as major banks won't provide the same boost GM would receive with its own finance company. They see the latter as a step toward eliminating the disadvantage, these people said.

"GM expects to continue its relationship with GMAC, now known as Ally Financial Inc., but the auto maker will look to other lenders to fill gaps where it feels GMAC hasn't been as willing to make loans, such as in subprime lending and leasing, these people said.

"'By not financing [sub-prime] consumers, they are locking out about 40% of the US population,' said Melinda Zabritski, director of automotive credit for Experian Automotive.

"The approach diminishes the possibility that GM will start its own finance company to try to regain control of GMAC's auto-lending business, two options the Detroit company studied in recent months. Ally wasn't interested in such a deal, the people familiar with the matter said.

"GM dealers have complained that they are forced to turn away some customers because of an inability to tap financing.

"Driving up sales is a key mandate from GM chairman and Chief Executive Edward E. Whiteacre Jr. The company's sales this year were up 15% through May compared to a year ago despite shedding four of eight brands, but rival Ford Motor Co., which owns Ford Motor Credit Co., increased its sales at twice that rate.

"In working with other lenders, GM is looking in part to expand its loans to riskier buyers.

"Subprime lending comes with the potential pitfall of higher default rates, which stung auto lending amid the US economic meltdown, and continue to remain above average.

"But done properly, lending to consumers with subpar credit had proven to be profitable for captive finance companies and other financial institutions, Ms. Zabritski of Experian said.

"GM last year made a deal with AmeriCredit Corp. to provide loans to subprime borrowers. Under this arrangement, which is continuing, GM augments the loans with cash incentives so it can offer more competitive rates.

"GM would like to broaden its offerings beyond AmeriCredit. Lenders frequently limit the amount of the loans they provide, particularly if there is more risk involved, so having arrangements with more lenders would further expand its offerings.

"GM is at a particular disadvantage if it can't reach buyers with weaker credit scores because they constitute a larger portion of its customers relative to some rivals, including Toyota Motor Corp, which generally attracts people with higher credit scores, Ms. Britzka said.

"Subprime borrowers, which could encompass people with credit scores from 300 to the mid-600s, account for around a quarter of all US car loans, according to Experian. But only about 6% of GM's car loans go to such consumers, Experian said.

"A recent study by AlixPartners, a business advisory and restructuring firm, found that customer loyalty improved significantly for car buyers who received financing through an auto-company lender. The arrangement helps car companies stay in better contact with buyers and lets dealer know when vehicle owners may be in the market for a new car or truck, such as when a lease ends.

"GM hopes to tap these same benefits in its relationship with outside lenders, said the people familiar with the situation.

"GMAC cracked down on car lending amid the economic meltdown in 2008, a move that hobbled GM and preceded the auto maker's descent into bankruptcy.

"Ford and Toyota, which also has its own captive lender, were able to offer cheaper loans and leases during the turndown.

"The availability of financing for GM customers improved after GMAC, through the bailout of the US banking industry,

received $16.3 billion in US government loans. GMAC, now controlled by the US Treasury, played a key role in helping stabilize GM and rival Chrysler Group LLC, which also relies on GMAC for customer financing."

We are obviously heading at accelerating speed to a state of affairs where gullible investors will be investing in used cars without fully appreciating the hazards an interest in one where one of the wheels including, let as say a 20% of the rubber in one of the tires and, a quarter of the wheel frame may have been acquired by another innocent investor who was unaware that the bans that sold him the "deal" had already done a deal the would allow some bank or other financier, to come out of the "deal" with a double profit plus a commission or two on selling them one of the four wheels plus a 27% interest in the rubber of one of the tires plus a 24% interest in the steel frame of one of the other wheels.

Heard all this before? For good reason. It is well on the way to becoming the dominant way of financing the future of a world that has suppressed its history, limited what can be taught or even mentioned in the economic courses in most of our universities, to make the world safe, and even insured against the slightest chance that the average citizen can take care of her life's savings.

W.K.

How Goldman Bled the Government Via Its Insurance

The New York Times (01/07, "How Goldman Pressed AIG for Cash" by Gretchen Morgenson and Louise Story) reports on a crucial interview: "Executives of Goldman Sachs and the American International Group, the Wall Street titans whose long alliance dissolved into a battle that shook the financial world, defended their actions on Wednesday before the federal commission investigating the financial crisis.

"But perhaps more revealing than the executives' explanations was the release of 500 pages of documents by the panel, the Financial Crisis Inquiry Commission, showing how Goldman's aggressive and repeated demands for billions in cash from AIG drove the insurer to the brink of failure in September 2008.

"The documents also revealed for the first time the dollar amounts behind Goldman's negative bet on AIG which Goldman put in place to hedge its risk that AIG might fail and not pay its obligations.

"'Goldman was first going in the door asking for collateral. Goldman was by far the most aggressive in terms of timing and amount asked for,' Phil Angelides, the chairman of the commission, said. 'You were way ahead of everyone else in terms of the amount being demanded and the timing for that.'

"The collapse of AIG, once the world's largest insurer, and its dealings with Goldman and other major banks in the months leading up to that failure, have been the subject of significant Congressional interest since it was bailed out by the taxpayers in the fall of 2008.

"Under the terms of the $182 billion rescue, which was overseen by the New York Federal Reserve and the Treasury, the banks had insured mortgage securities with AIG were made whole on those contracts when they agreed to unwind them. Some $46 billion of the AIG bailout money went to the banks. In his first public appearance since AIG's collapse, Joseph J. Cassano, the former chief executive of the unit that insured the mortgage securities, said that he had fought back banks like Goldman until his retirement from AIG in March 2008.

"He told commission members that he could have saved taxpayers billions of dollars if he had stayed at the company as 'its chief negotiator' because he knew the ins and outs of AIG's legal contracts with the banks.

"'I would have gone to the counterparties, and I think even then I would have been able to negotiate substantial discounts by using the rights available to us, such that the taxpayer would not have to accelerate the $40 billion to the counterparties,' Mr. Cassano said.

"AIG's battle with Goldman began in the summer of 2007 and, the documents show, centered on the value of the underlying mortgage securities that AIG had insured. The documents include a time-line of Goldman's collateral calls and show that in the summer of 2008, Goldman had at one point received nearly half of all the cash AIG gave to counterparties, even though Goldman's deals with AIG made up only a fifth of the insurer's book of business insuring complex mortgage securities.

"While Mr. Cassano remained at AIG, the insurer resisted when Goldman demanded cash to shore up deterioration in the securities. AIG officials argue that the investment bank's valuations were inappropriately low and were well below those of any other dealer on Wall Street, the documents show.

"For example, on February 6, 2008, even as AIG's dispute with Goldman over valuations was escalating, the documents indicate that requests for cash from Société Génerale, another large AIG trading partner, using values that were in line with AIG's assessments.

"After Mr. Cassano left AIG, Goldman succeeded in more of its demands for cash. When Mr. Cassano left, AIG had put up $3 billion; six months later, AIG had transferred $7 billion to Goldman.

"The market for mortgage securities was declining during this period, but the commission documents indicate that Goldman's demands were far more aggressive than that of other banks.

"When asked by Commission members about this, Goldman's valuations came from actual trades at the time the cash demands were made. Mr. Angelides of the commission asked Goldman to provide evidence that such trades had actually occurred.

"Most of the contracts were dismantled by the New York Fed during the bailout of 2008. It retained the risk of the mortgage securities that AIG had insured.

"Goldman was one of the largest banks on the other side of AIG's mortgage deals, and executives of that bank, including Gary D. Cohn, the president of Goldman, also testified on Wednesday.

"Mr. Cohn said that Goldman's collateral demands of AIG were justified under the bank's valuation rules.

"'We did not call for collateral because we anticipated the eventual scale of AIG's problems,' Mr. Cohn said in his testimony, 'we simply stuck to our risk management protocols.'

"Mr. Cohn also said that as Goldman issued demands on AIG, it bought insurance on AIG As a whole, in case the insurer failed. The commission released the dollar amounts of that protection over time, showing that Goldman first bought the insurance in July 2007, when it began making demands on AIG."■