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Has This Petty Response to the Mulroney File Warranted So Much Grand Staging?

For the reopening of the Brian Mulroney file the stage was set as for a grand production, even suggesting the replacement of one set of legendary gods with another. Let us say it reminded you of Richard Wagner's Nibelungen Ring, a cycle of four vastly conceived operas. But when the evidence came in, a mere $300,000 of alleged relatively small-time graft was mentioned in alleged behind-scene financial transactions of our ex-PM and Karlheinz Schreiber – some $300,000 of bribes alleged to have been passed by a mid-sized German-Canadian lobbyist for his help in a deal for planes from Airbus, which was then still a European government corporation. The Royal Canadian Mounted Police had investigated the matter some years ago but were clearly unhorsed, hence the government had paid Mr. Mulroney Canadian $2.1 million to make amends.

In contrast let's get a whiff of the cosmic scope of Richard Wagner's Nibelungen Ring to appreciate these discrepancies of scale. In the Nibelungen Ring the dwarf Alberich steals the gold of the Rhine River, and by renouncing love acquires power over the world. He is thus able to force his fellow-dwarfs to work for his goal and seek out the ablest smith amongst the giants to fashion a magic ring from the purloined Rhine gold. All this, and much, much more he achieves after renouncing love for worldly power. Over generations in quest of that magic ring, different gods, giants and others succeed one another to power. The magic ring passes from hand to hand over generations until it is finally returned to the Rhine, and thereby the godly dynasties are superseded., and love reigns supreme.

Such is the cosmic framework for which the stage of the Brian Mulroney Enquiry reminded us of. To reduce it to an enquiry concerning a supposed purloined $300,000 fails doing justice to the basic principles not only of stagecraft, but of our history.

The detail that the Brian Mulroney matter should been revived at the very time that our financial system is again in deep crisis over Deregulation and Globalization – this time over subprime mortgages and risk management and much, much else – is clear proof that the enquiry must not stop with the relatively trifling tips allegedly passed by Schreiber to Mulroney in cash slipped from one to the other in fashionable hotels. More to the point is that on our law books – and accessible on Internet through Google – the *Bank of Canada Act* still sets forth the ability of the federal government to finance both the federal government or any province of this land, by holding its funded or unfunded debt. And since in 1938 the Bank of Canada's 12,000 original shareholders were bought out by the federal government, it means that by holding federal debt, the central bank would be financing essentially interest-free any capital investment that our federal government would make. For all net income of the bank comes back to its sole shareholder as dividends – the most capitalist of all economic institutions. Moreover, in subsections 18(c) and (j) of the Act you will find the amount of lending that the Bank of Canada is allowed to make both to the federal and the provincial governments ($^1/_3$ of the entire budget of the federal government,

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Mulroney *continued from page 1*

and 1/4 of the budget of any provincial government). That is a great deal of money even if is more like a current bank debt. But the Banks is also able to trade in any federal or provincial debt and in any debt guaranteed by the federal or a provincial government. There is nothing in the Act that would suggest that would exclude the debt of our municipalities,

However, in the case of loans to anyone but the federal government the interest paid to the BoC (Bank of Canada) would end up substantially with the federal government and not automatically return to provincial or municipal borrowers who, unlike the federal government, are not shareholders of the BoC.

CDOs and CODs

However, given the background of Deregulation and Globalization, there would be compelling moral reason for Ottawa to reach an agreement to return to them a portion of the dividend accruing to it as interest for such loans from the other government level to them. For a long and doleful tale attaches to the deregulation and globalization of our banks after their disaster in the 1930s, that led to the creation of our central bank, in 1935, with 12,000 private shareholders but who were bought out just three years later at a good profit by our national government, All this blew in from the United States, but in Canada the Roosevelt bank legislation was actually taken further than in the US.

By the time Roosevelt was inaugurated for his first term in 1933, 38% of US banks had closed their doors, and one of the first things he did was proclaim a bank moratorium, and renewed it when it expired. Not a bank functioned in the land. When they were allowed to open again under government guarantee of their deposits received from the public, they were obliged to confine themselves strictly to banking and not acquire interests in the other "financial pillars" – insurance, stock brokerages, and mortgages. The reason was good enough: give the banks access to the cash reserves that these other "pillars" need for their own business, and inevitably they will again as in 1929 utilize them as cash base for applying the "bank multiplier" – not mentioned these days but that exists heaped up many storeys to skyscraper heights. The currently fashionable name for these storeys is CDOs – Credit Debt Obligations. These have replaced Cash on Delivery (COD) that used to rule the roost. What bank these days are regurgitating had until recently been accepted as the very newest basis for our economic system. High executives' options and stock market appraisals were based on ever more complex derivatives of profit and loss or the rate of growth of profit or loss, no matter to what higher degree. And where did this come from? Why, from globalization and deregulation that was to save the world by both deflating and inflating the economy. What was overlooked was that none of the mythology of Globalization and Deregulation will stand up when you deflate the producing part of the economy to inflate the speculative part. Yet that is what D&G is basically about.

The Case of Oil

A good instance is our world oil prices that have now exceeded the usual US dollar price very recently beyond even speculators' imagination – $100 a barrel. But of this at least $40 is the shrinkage of the dollar and much of the rest is substantially the result of poker games being played with "a thousand barrels of oil" or whatever written on the cards in invisible ink, but only very remotely related to oil quantities that actually change hands between producers and consumers. A standard example of what happens when CDO and COD encounter and mate.

That is how the plethora of autonomous money that the world is currently ailing from came into being. The price inflation that Fed chieftain Greenspan was told to shut up about was that of the stock market.

What he was encouraged to pursue with higher interest rates was commodity inflation, which was identified with any increase in commodity prices. But when anybody moves from a town of, say 100,000 let alone the countryside, to New York City, he can't expect his living expenses to remain the same. How then could economists for a moment assume that it can and must do so, and enforce that impossible edict with higher interest rates which happen to be the primary income of the banking and speculative interests?

Once the banks of the US and Canada were healed by the rather passive banking imposed on them during World War II, they longed for the good old times before 1929 and conspired to bring them back. The effort was organized from a seemingly neutral war-room. The Bank for International Settlements (BIS) based in Basel, Switzerland, was essentially a central banker's club from which political leaders were excluded. Proscribed at the Bretton Woods Conference of 1944 (Resolution 5) for its surrender to Hitler's army of the Czechoslovak gold reserves entrusted to it when it entered Prague, it had been tagged for early dissolution. But a favour done the British in rearranging their war debt turned the trick, and the low profile it had to cultivate because of that background ended up recommending it as a semi-underground war room for planning the comeback of the world's banks.

By the 1980s this, begun behind President Harry Truman's back by his own Treasury, had proceeded far enough for the US banks to have taken over the Savings and Loans – essentially mortgage trusts – that had to be bailed out by the US government. when mortgages were grossly oversold by banks that didn't really know what they were doing. By the 1990s the banks had been taken care of in a double way. The Risk-Based Capital Requirements sponsored by BIS had declared the debt of governments of advanced countries "risk-free," and hence requiring no down payment for banks to acquire. This permitted Canada's banks to increase by some $60 billion (Canadian) the debt they held to $80 billion, restored to them the down-payment they had paid on the original $20 billion held.

The End of the Statutory Reserves

And in 1991-3 came the second measure bailing out the banks. The statutory reserves that the banks had redeposited with the central bank (and on which they had earned no interest) were phased out. Once the private banks held government debt, the interest on it stayed with them Between that and the saving from no longer having to redeposit the statutory reserves on their deposits from the public at a time when interest rates were being pushed into the skies allegedly "to lick inflation" at least doubled their take since the spread between what they paid their depositors and what they charged the public widened wondrously, as never fails to happen when a privileged class is decked out with unique power.

However, in their plotting and planning for an ever more globalized and deregulated banking system that would take in the entire world economy, the BIS overlooked a detail. If you allow the banks to build their hoard of 100%-leveraged government bonds, and at the same time screw up the benchmark interest rate to the heavens to "wipe out the last trace of inflation" – what inevitably ensues is that the market value of pre-existent bonds of which the banks had so many – collapses, the banks and their creditor risk becoming insolvent once again. And if BIS manager Alexandre Lamfalussy narrowly missed bringing down the world banking system through this amazing oversight, it was because US President Bill Clinton and his Secretary of the Treasury, Robert Rubin, grasping what was happening, got together the largest standby fund to that date – $51 billion put up by the US, the IMF and Canada. That saved the day, but frightened the wits of the highest government US circle into lucidity.

For decades American political leaders had turned deaf ears to the urging of leading economists and accountants who urged that the capital investment of government be treated as such, and depreciated over their useful lives and not in a single year when their financing had been arranged. That happens as a matter of course in the private sector. Any factory-owner attempting to write off the cost of his buildings or machinery or other investment in this way would be prosecuted fore tax-evasion. But corresponding to the dominant position acquired by finance capital no alternative to higher interest rates as the means of "licking inflation" remained. It was the class-war doctrine of the financial group enthroned: governments are by their nature seen as incapable of making investments. Governments, apparently, are only for bailing out the banks more often on the average than once a decade from their major speculative losses.

Faced with the prospective of a world-wide bank collapse – it was the end result of globalization and deregulation, that these periodic disasters had become world-wide, and no part of the banking world remained in form to give the local governments time to make good their local banks' speculative losses. All such disaster – by grace of globalization and deregulation become ever more global in their impact. Oddly enough the connection has still to be made.

The US Brings in Capital Budgetting

Washington, frightened by what it had wrought, brought in what it had resisted for decades – accrual accountancy also known as capital budgeting. Instead of writing off a government investment in a highways as bridge, a building over its natural life it had written it off in the year of completion and original payment. That means that its unused asset value was gradually depreciated more or less over its useful life – though the land under such investments was in fact likely to increase rather than decrease in value. Carrying them on the government books at a token dollar had several highly useful features. It created a huge deficit that was not really there. But that bad accountancy masquerading as a deficit was immensely serviceable to the militant property classes as an argument that the country could not afford the infrastructures needed for a modern, high-tech, urbanized society.

Even today – almost a half century that a significant school of economists – drawing on the unexpectedly rapid reconstruction of both Germany and Japan after the physical destruction of WWII reached the conclusion that this was due to their highly educated and skillful work force had come out of the war essentially intact. They concluded that investment in human capital was the most productive investment that a government could make. For that Theodore Schultz was awarded the Bank of Sweden's so-called Nobel Prize for Economics, in the 1960s, but his theory was soon expunged from official textbooks and respectable economic discourse. And that suppression deepened the chasm between official theory and the creed of Globalization and Deregulation.

Given this background ushered in under the government headed by Brian Mulroney, my readers should have enough to form an opinion of how disastrous the prime ministership of Brian Mulroney was for the land. It was not the $300,000 of alleged bribery. Many thousands of times as times as costly and harmful to Canada was his readiness as often as not to grant and even top the increase every concession that the United States asked of Canada. Thus in 1982 when Canada's Constitution was being drawn up, the Mulroney government drafted two items for insertion in the Constitution. One was the independence of the Bank of Canada from the government. But surely that flies in the face of the basic principle of ownership, since in a Depression-ridden decade (1938) the federal had bought out 12,000 private shareholder of the BoC, paying them a good profit when profits were scarcer than hen's teeth. In subsection 14(2) the Minister of Finance on matters of basic central-bank policy the decision if clearly in the event of a disagreement between the Minister of Finance and the Governor of Canada, the decision is clearly left – after 30 days of notice – with the Minister of Finance, and the Governor agrees to it or leaves his post.

Likewise "zero inflation" was to be written into the new Constitution and thus could not be changed. However, defining every movement of the price index – with the wretched accountancy discussed in a previous paragraph, and given the deregulation and globalization policy that was already being railroaded through in Canada and throughout North America, made it clear how important the exchange rate had already become by 1982, when these measures were proposed for insertion into our Constitution.

The government's proposals were turned down by the government's own caucus of the Finance and Banking Committee of the House of Commons turned down both proposals.

The Bank of Canada — The Cut Flower in Canada's Constitutional Garden

And that explains why we still have the *Bank of Canada Act* still on our law books, though it is never referred to and the provisions for financing the provinces and the municipalities on whom the federal government has in careful step one at a time has down-loaded the repeated, ever more massive bailout costs of our deregulated and globalized banking system, from the federal government to the provinces in the first instance, with insufficient funds to pay for the responsibilities, and then to the municipalities. And though the Bank of Canada in its early years lent money not only to the federal government but to the provinces and to the municipalities with guarantees of a senior government. Any enquiry from municipality after municipality – all of whom pass an increasingly potholed existence. They are simply informed that it is not possible.

That strikes at the heart of our democracy, as does the *Bank of Canada Act*, declared non-existent not by the Parliament of this land but by Brian Mulroney in spite of the position of his own parliamentary finance Committee caucus. We should remind all parties in Parliament – from the Conservatives, through to the Liberals, the NDP and the Greens, strangely quiet on these key matters, of a wise saying: "Who steals my purse, steals dirt." Mr. Schreiber's $300,000 certainly falls under that heading if you compare it to the stunted democracy in our land because of the disregard of the *Bank of Canada Act* that was never repealed. Thereby hangs further dark tales. For if Parliament were on its toes, it could have warned our government and our public

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Sectarian Frustrations to Economic Reform

Writings of J.W. Smith have been featured in ER *in the past, as have those of Michael Hudson. An exchange between them is therefore of interest, and has just fallen into our hands. The following letter by Hudson has been edited and paraphrased to provide some explanatory notes and to meet space restrictions. It illustrates the tendency of political economic thinking to deteriorate into sectarianism and consequently to frustrate efforts to get effectively beneficial reforms. Unscrupulous ambition is left to dominate the field with impunity.*

Keith Wilde

Nov. 29, 2007

Dear Mr. Smith,

I thank you for your two books just arrived. I'd already glanced through one of them, provided by Dennis Kucinich's staff. [Ed. note: Hudson is chief economic advisor to Kucinich's campaign for the Democratic presidential nomination in 2008.]

You are right that the stock market (as well as the supply of bank credit) represents mainly "capitalized appropriated values." [Ed. note: The meaning of this phrase is clarified in the body of the letter. Less polite wording would be "ill-gotten gains."] Seventy percent of bank credit is mortgage loans, and the worth of both banks and the stock market is based largely on what is more accurately designated as economic rent than the profits of tangible capital investment. Economic rent is the "free lunch" and it should indeed be the target of taxation. (Or, it should be minimized by public operation of natural monopolies, as traditionally was done in Europe.)

That principle will be the basic thrust of the tax platform we are just now in the process of writing. [See the definition below of "economic rent as that element of price that has no counterpart in actual cost of production."]

Where we diverge is in the political way to achieve this policy. You hope that your reasonable tax proposal will be endorsed by groups that promote the ideas of Henry George. I expect you will find instead that they are your most vehement adversary. The position of several prominent spokesmen for them is that "only socialists talk about credit." This means that the bank credit you describe as capitalized economic rent should not be taxed. It should rather be "freed" to continue converting monopoly rent into capital.

At first glance you would seem to be right in noting that Henry George did occasionally criticize monopolies. Just about everyone did in his era. But he refused to tax them, and even refused to include monopoly gains in the concept of economic rent. In fact, he had no concept of economic rent in the classical sense used by Ricardo, J.S. Mill and the political economists who wrote after him. He saw only land rent, and expelled from his movement any would-be supporters of a land tax who also suggested that monopoly gains should be taxed.

Consequently, George played no role in the great Progressive Era reform and muckraking movement, except to attack it with a bad temper. Today's Georgists thus are simply carrying on his own narrow-mindedness, with equally autocratic sectarian organizations. [Details and personalities excised here to save space.]

Henry George's Exclusive Bad Temper

I discuss the break of Progressive Era reformers with George, and provide a full panoply of citations, in this [2008] January's *American Journal of Economics and Sociology*, in my article on Henry George's Political Critics. I demonstrate there that Georgists have made the land tax academically unacceptable – at least in conjunction with George's own name. And it is their own choice. Just as George himself boycotted academia, so do his followers today.

For example, Alfred Marshall was so dismayed at George's failure to understand economic rent as that element of price that had no counterpart in actual cost of production (ultimately resolvable into labor costs) that he is said to have removed *Progress and Poverty* from the Cambridge University library. As I'm sure you know, he generalized the concept of economic rent as accruing not only to land and mineral deposits, but also to monopolies and finance, along with quasi-rents for low-cost industrial producers. This became the main way in which rent theory survived in academia.

George rejected this road. He supported capital to such an extent that he made little effort to explain just where its profits ended and monopoly rent began. His illustrative examples in *Progress and Poverty* depicted workers as making their own tools – axes or canoes – and deriving a profit from their added productivity, like small businessmen working on their own account. To him, capital was merely tools that embodied labor. By contrast, socialist and labor reformers conceived of capital as expensive machinery in large urban factories. *Capitalists* employed labor under exploitative terms or exerted strategic monopoly [toll-gate] positions for extortionate revenues without costs. George's followers have maintained this position and further confused the issue with a cultish vocabulary that conflates "profit" with "interest" as if they were the same thing. [This sanitizes interest since profit is justifiable in most standard economic theory.]

By defending interest, therefore, the Georgists endorse precisely what you fight against. [For interest is the income from "capitalized appropriated values."]

Although George advocated that natural monopolies should be publicly operated, starting with the railroads and telegraph, he felt so strongly that a land tax had to come first that he directed his followers not to press for other reforms until the Single Tax was enacted. This meant not working with groups that focused on these reforms, despite their harmony with his beliefs regarding the land tax.

Denouncing groundrent as the unearned income of "privilege" won George a large following. But as Simon Patten summarized George's one-sidedness position in 1891, he "thinks our whole civilization is at stake; that there is no other remedy for our present evils but a radical change in our system of land-tenure; that if this one evil were removed, all other evils would disappear of themselves; that no progress can be made without the change he advocates, and that there is no other remedy but the one he has in mind."

The problem, Patten explained, was that moving against just one monopoly (land) would simply leave more economic rent for others to appropriate. "It is, therefore, a popular error to suppose that the rent of land absorbs the whole of the surplus. According to the Ricardian theory of distribution, this would be so, but this theory gives an undue emphasis to land as an economic factor…. The surplus, however, may be absorbed in many ways…. Our railroads are now getting a large share of this surplus. As the owners of farms are separated from the market of their produce by long distances, they must make use of our railroad system to transport their grain.

Any increase in the rates of transportation, therefore, will act as a reduction of rent, and if the railroad system of our country has its stock largely watered, it will reduce the value and rent of lands, and in this way a large portion of the surplus will go to the owners of railroads, rather than to the owners of land." [Contemporary Georgists rant against Patten as a critic, refusing to acknowledge the substance of his critique or to recognize that Patten was all in favor of a land tax.] The closer one comes to supporting land taxation or monopoly taxation, the more the Georgists attack, as if to say "get off my territory." (It seems that their hatred of Patten stems from the fact that his 1890 article on George and John Bates Clark anticipated by over a century, almost word for word, Mason Gaffney's article in *The Corruption of Economics*.)

At the request of officials from several Georgist funding organizations, I have agreed not to mention Henry George in any way in either my public speaking or writing or that of Dennis Kucinich. I'm on friendly terms with many other Georgists who share my impatience with the seemingly endless personal attacks from their official spokespeople. If talking about finance and quantifying the magnitude of land rent, other economic rent and land valuation is "socialist," we're prepared to go that way and look for support on the non-cultish front, where our ideas of land taxation are welcomed without the "not invented here" attacks we get from the Georgists.

As far as your work is concerned, I think you would have much better luck presenting it simply as classical economics. It was indeed the essence of liberal British political economy, and also that of France, as well as American Progressive Era politics. The fact that George was such an enemy of environmentalism and attacked critics of ecological pollution is yet another reason why we must avoid his name and his groups like a plague. We do indeed want to guide trade policy to minimize environmental degradation. George was all for it. (My *AJES* article provides citations.)

The bottom line seems to be this: Isn't it an oxymoron to combine a land tax with libertarian philosophy, anti-tax and anti-government and anti-regulatory as it is?

Sincerely,
Michael Hudson

"US Republicans Losing Grip on Core Business Vote?"

Under that trumpeted caption (*The Wall Street Journal,* 2/10), Jackie Calmes sets forth a tangle of reasons why that should be the case. Great powers misreading their waning strategic might rarely, if ever, tend to extend their rule into continued military adventures that they are no longer capable of handling: "The Republican Party, known since the late 19th century as the party of business, is losing its lock on that title.

"New evidence suggests a potentially historic shift in the Republican Party's identity – what strategists call its 'brand.' The votes of many fiscal conservatives and other lapsed Republicans are now up for grabs, which could alter US politics in the 2008 elections and beyond.

"Some business leaders are drifting from the party because of the war in Iraq, the growing federal debt and a conservative social agenda they don't share. In manufacturing sectors such as the auto industry, some Republicans want direct government help with soaring health care costs, which Republicans in Washington have been reluctant to provide."

We could well pause here to note this as a major shift in political plates deep beneath land and the great political waters. It reflects what the late unjustly forgotten French economist François Perroux called "the dominant revenue" that in all societies reflects the revenues of a particular empowered group, and misreads their income and its rate of increase as a faithful index of the welfare of society as a whole. Under feudalism it was the large landowners, in the age of the industrial revolution it passed to the industrialist, and today it has moved from the industrialists to the financial sector. That involves globalization and deregulation to provide adequate play areas for the banks. It has also spelled ruin for countless industrialists swept under by the cheap outsourcing of many manufacturing industries. Clearly this has not strengthened the loyalty to the Republican Party of the industrialists hanging onto that category by their finger-nails if at all.

And some business people want more government action on global warming, arguing that a bolder plan isn't only inevitable, but could spur new industries.

"Already economic conservatives favouring balanced budgets have become a much smaller part of the party's base. But it's also the result of defections of other fiscal conservatives angered by the growth of government spending during the six years that the Republicans controlled both the White House and Congress.

"The most prominent sign of dissatisfaction has come from former Federal Reserve Chairman Alan Greenspan, long a pillar of Republican economic thinking. He blasted the party's fiscal record in a new book. He said, 'The Republican Party, which ruled the House, the Senate and the presidency, I no longer recognize.'"

And yet if you must globalize and deregulate, you get into confrontations on a world-wide scale. And when your traditions and culture – as so brilliantly described by Morris Berman in his *Dark Ages America,* which we recently reviewed two snippets of, militate against your capacity for dealing with other cultures, that is tantamount to Washington going shopping wholesale for trouble abroad. The resultant military involvements do not come cheap and rule out balanced budgets up to traditional Republican standards – even avoiding mention of the wretched accountancy of the US government in keeping its books.

Military Adventures Do Not Come Cheap

"Polling data confirm business support for the Republicans is eroding. In the *Wall Street Journal*–NBC News poll in September, 37% of professionals and managers identify themselves as Republican or leaning Republican down from 44% three years ago.

"Federal campaign finance reports document shifting support in some quarters of the business community. Hedge funds last year gave 77% of their contributions in congressional races to the Democrats, up from 71% during the 2004 elections according to the Center for Responsive Politics., a non-partisan analyst of campaign finances.

"In Washington, Republican leaders' relations are no longer as cozy as they once were with the US Chamber of Commerce, the nation's foremost business group. 'It's a much more complex relationship than it need be,' says Chamber political director, William Miller.

"For example, he says the Chamber supports a higher gasoline tax if revenues are dedicated to funding highways and bridges that truckers and other businesses want, and to hold down deficits. The split comes atop other tensions, especially immigration. As the party's base has shifted south and west, it has become more protectionist and focused on secure borders. Business generally favours free trade and immigration laws that keep workers coming and employer sanctions to a minimum."

"Nationally, support for some Republican causes espoused by social conservatives and hawks has declined in the general population as Americans have grown more concerned about economic matters. The Pew Research Center based on its latest surveys on American attitudes, found that between 1987 and this year, support for 'old-fashioned values about family and marriage' had dropped 11%. The percentage who say gay teachers should be fired dropped 23 points. Pew said support for US global engagement and 'peace through military strength' also shrank. Three-quarters of the population is worried about income inequality, Pew found, while two thirds favour government-funded health care for all. 'Support for a government-funded safety net for the poor is at its highest level since 1987,' Pew said."

However, for the final word on the matter, let us return to Morris Berman's *Dark Ages America – The Final Phase of Empire:* "One has to wonder how exaggerated comparisons between the Bush administration and the Third Reich, which at first glance seem preposterous, really are. Was it an accident that, in the fall of 2004, Philip Roth published *The Plot against America,* a novel about fascism come to America that has eerie echoes of our present situation? Or that the eminent historian Fritz Stern referred to Bush's 'mission accomplished' landing on the US *Abraham Lincoln* in May 2003 as part of the Leni Riefenstahlization of American politics?' The truth is that there are creepy parallels, and they may get creepier. All the social analysis of the 'It can't happen here' variety, beginning with Erich Fromm's *Escape from Freedom (*1941) are tied to a critique of popular culture that points to the existence of a large mass of people who are unable to think for themselves, operate out of an emotive basis, confuse education with beliefs, and desperately wanted to be 'filled' from the outside…. That Fromm held that a big part of this attraction was the need for a father figure who acted with conviction – someone who, in uncertain times, was perceived (even unconsciously), as being able to allay widespread anxiety. And what kind of 'father' is G.W. Bush? What does it mean after all to have an anti-Enlightenment President, and an American majority so easily seduced by faith-driven discourse? Obviously, Roth et al. (and I) could be accused of paranoia here, but I can't help wonder whether America can't help drifting towards an ominous situation, with all 'being willed by God.'

"The opposite of the Enlightenment, of course, is tribalism and group-think. loyalty is everything, and it was just this kind of tribalism, I believe, that got Bush reelected. Harvard University's Simon Schama notes that although Kerry won the televised debates, the real victory 'was one of body language rather than rational discourse.' Thus Kerry's charge that the Iraq war had made America less, not more safe, and had served to recruit more terrorists to the Al Quaeda cause failed to register with the majority of voters. Why, asks Schama, would that be?

"Because the President had 'acted,' meaning he had killed at least some Middle Eastern bad dudes in response to 9/11. That they might be the wrong ones, in the wrong place – as Kerry said over and over – was simply too complicated a truth to master. Forget the quiz in political geography, the electorate was saying – it's all sand and towel-heads anyway, right? Just smash them – like ripe cantaloupe. Who them? Who gives a shit? Just make testosterone tingle all the way to the polls!"

W.K.

Mulroney *continued from page 4*

against subprime mortgages, collateral debt obligations, risk management.

If we are going to discuss Brian Mulroney's contributions, let's not settle for the peanuts about Mr. Schreiber's $300,000 bribe, but go directly to the real crux of Mr. Mulroney's contribution to our economic troubles. We are running a highly modernized land with a central bank not by the legislation adopted by our parliament, but with improvisations that bring back conditions that brought on the crisis of the 1930s.

But without such institutions, no country can depend successfully on individual prowess to defend its liberties and progress. For that you need the backing of adequate institutions. If there is going to be a serious enquiry into the damage that Brian Mulroney did this land, let's deal with the *Bank of Canada Act,* which he consigned to the limbo where it rests today.

William Krehm

How Some Men of Great Talent Go to Bed with their Conscience When a Luctrative Career Stands in the Way

The New York Times (07/11, "For Citigroup's new head, Focus is Subprime Tangle" by Eric Dash) gives us a glimpse of how some men of great talent prevent their consciences from standing in the way of lucrative careers. As Bill Clinton's Secretary of the Treasury, Robert Rubin, like his boss, was at the very center of affairs that counted. The first sour fruit of globalization and deregulation as evidenced by the Mexican bank crisis of 1994 were dropping all over the lot. The Mexican government had taken the North American Free Trade Agreement so seriously that it actually shorted its own currency. This it managed by *tesobonos*, government bonds that gave the holders the option of having them paid when due in US currency, even though they had been purchased for pesos! No lack of Mexican politicians' palms itch sufficiently for such performances. On this occasion it led to a drop of some 40% in the value of the peso in dollar terms.

Ultimately so gross a sell-out led to a new clique of stock-brokers replacing the banks entrusted with the marketing of the national debt. It required the government taking over the country's banks to make them whole enough for 85% of the banks of the land to be sold off to foreign banks. The deep economic depression from the resulting mess helped unleash the flood of Mexican emigrants, legal and illegal, across Mexico's northern border, and led to the what may be the greatest wall-building project since ancient China.

Loading the Banks with "Risk-free" Government Debt

Globalization and Deregulation of the world banking system, of which the Mexican episode was certainly a high point, brought Robert Rubin's great gifts to the fore – not excluding his talent for managing his conscience. By 1988, the US banks having bogged down in an earlier attempt to take over the mortgage business, had lost much of their capital, and to their aid came the Bank for International Settlements (BIS) – a sort of central bankers' club that had become the war-room to plan and execute the comeback of the world's banks to the glories that led to the Crash of October 1929.

Two principal measures towards this goal were designed by BIS. The Risk-Based Bank Capital Requirements in 1988 declared the debt of the central governments of developed lands risk-free, and hence requiring no down-payment for banks to acquire. All they needed to replace the banks' lost capital was to cash in on the coupons. But for the bailout of the banks from their losses, massive transfers of government debt from the central banks to the private banks became necessary and feasible. In countries like Canada where the government had bought out the private shareholders of the central bank, this involved the dividends to the government that since 1938 had become the Bank of Canada's one shareholder. But even in countries like the USA, where private banks owned the Federal Reserve system, the central bank, almost the same portion of the profits of the central bank found its way to the government, on different formal grounds.

The interest on the government debt held by the Federal Reserve found its way back to the government as a continuation the ancestral monarch's monopoly in coining and recoining gold and silver, known as *seigniorage* – an established form of revenue of the monarch arising from his ability to recoin the coins with a lesser precious metal content.

However, a few years later, the same BIS, distraught by the confusion created by the deregulation and globalization that it had sponsored, raised to a new high pitch its campaign for pushing up interest rates until inflation had been reduced to zero. No matter how high the respective banks – the head of the Federal Reserve, Paul Volcker, or John Crow, Governor of the Bank of Canada – shoved up their benchmark interest rate, they still left the manager of BIS, Alexandre Lamfalussy, unhappy because the price level had not been reduced to absolute flatness.

However, a detail escaped BIS that could not have escaped Robert Rubin, who was then Clinton's Secretary of the Treasury. If you hoist interest rates into the heavens to make prices lie prone, the market value of preexistent government debt paying lower interest rates falls steeply. And that indeed is what ensued and threatened to collapse world monetary system. It was largely Treasury Secretary Rubin who rose to the occasion. With the help of the International Monetary Fund and the Government of Canada, the US set up the greatest standby fund to that date. With the savvy he had developed during a lucrative career on Wall Street, Rubin came up with the means of getting BIS out of the corner in which it had painted itself. He realized – if a bit late – that the hoards of government debt held by the banks to fill the gaps left by their capital could not be reconciled with high interest rates. For the market value of the government bonds would collapse if interest rates soared higher than that of the banks' bonds, their market value of the bonds would shrivel, and bring the banks into trouble again.

How to handle that? That too, probably originated with the Secretary of the Treasury, who had the background to be aware of such matters, but had not allowed his knowledge to interfere with his Washington or Wall Street careers.

Extra, Extra — Washington Brings in Serious Accountancy

Government auditors and crusading economists had for years attempted to draw attention to the what can only be described as the anti-accountancy with which governments kept their books. When a private firm makes an investment in equipment or buildings, it will depreciate the asset acquired over its likely useful life. At the same time it will *amortize* the debt incurred to finance that investment, over as long a period that he can obtain from the financial interests that make the loan. Should a private businessman attempt to "write off" the value of a building or equipment, or a road or a bridge in a single year, he would risk ending up in prison for tax evasion. How then had our governments themselves for many decades managed to get away with the game? Because it created the impression of a government deficit that was not necessarily there, that misleading accountancy was very useful in turning down a public demand for more government services.

In the January 1996 figures of the US Department of Commerce on "savings" for the first time accrual accountancy was introduced to cover the physical investments of the federal government. And with the reworking of such investments as far back as 1959, it brought to light an additional value of depreciated assets approaching 1.25 trillion dollars that had been reported at a token value of one dollar.

But the value of these newly discovered "assets" was listed under the heading of "Savings" that economists usually use for cash assets or short-term securities of the highest quality, which are readily convertible to cash. That is not the case with forty-year-old physical assets. Yet, a wink and a nudge were sufficient to transmit to the bond rating agencies what the real facts were, and to bring down interest rates – kept high to keep the government from running up too much debt.

It should be noted that even with the introduction of accrual accountancy into the government's books to cover *physical* investments of the government, that still left the immense investment of government in human capital out in the cold. Economists like Theodore Schultz had been celebrated for having deduced from the surprisingly rapid recovery of Japan and Germany from the physical destruction in World War II that the most productive investment a government can make is human capital – education, and hence, too, health, and social services. But that, too, has been forgotten, and no government has applied its tardy extension of capital accountancy to human capital – investment made in education, and hence, too, also on health and social services to protect that the vessels that hold the most profitable investments that a government can make.

The New York Times (16/11, "Bank Profits Had Whiff of Suspicion" by Floyd Norris) returns to this subject with even more sharply pointed reference to the unique role of Robert Rubin: "When the history of the financial excesses of this decade is written, that will be a verdict of financial historians. There were signs that that banks were even

Yet Another Instance of the Forward Lean of Our World Economy

There are strange consequences of the forward lean imposed on the world economy by the assumption of power by world banking.

We are confronted with puzzling behaviour on the part of the largest world corporations, in the very years of near-monopolist boom years. For example, *The Globe and Mail* (13/10, "BP set to pay $303 million to settle suit" by Ann Davis, Houston, Guy Chazan, London, *Wall Street Journal* Staff): "Oil Giant BP PLC has agreed to pay 303 million to settle civil charges and avoid criminal prosecution in the US for allegedly cornering the propane market there in 2004, sending prices spiking as much as 50%, people familiar with the matter say.

"The settlement is one of a series of attempts by BP's new chief executive officer, Tony Hayward, to put behind the company a series of operational, safety and trading-desk problems the company suffered under Lord John Browne, who resigned as CEO following revelations he had lied in court about his private life.

"The energy-markets settlement, which includes civil penalties levied by the Commodity Futures Trading Commission, requires BP to undertake a series of changes to its compliance culture that could end its reign as Big Oil's most aggressive energy trader.

"The settlement, scheduled to be announced today by the US Justice Department and the CTFC, comes amid signs that turmoil in BP's storied and aggressive trading operations could be clipping its results.

"Without mentioning the settlement, BP yesterday blamed poor third quarter earnings and lower year-to-date results in part on a 'significant reduction in the contribution from the marketing and trading businesses.' While BP said the weaker conditions had to do with 'lower European heating-oil demand as a result of milder weather,' many other energy traders have had a banner year as volatile and rising prices have made for many trading opportunities.

"In addition, the CFTC is announcing a new civil case today against an individual gasoline trader at BP, lawyers informed of the case say. BP attorneys have been working overtime to settle probes involving its propane, gasoline and crude trading activities, particularly since last year, when CFTC brought civil charges manipulated the propane market in 2004. Investigators charged that BP's activities caused a brief 50% spike in propane prices at the height of the home-heating season, driving up heating and cooking costs for millions of mostly rural Americans.

"As part of the propane settlement, BP will pay $125 million in civil penalties to the CFTC, a $100 million in similar civil penalties to the Justice Department, $53 million to consumers of propane who lost money from the alleged price manipulation, and $25 million to a consumer-fraud fund, a person briefed on the settlement says.

"In addition, BP will submit for the next three to five years to oversight by a compliance monitor appointed by the government."

That leaves us with a nagging question. Why would one of the very largest of world oil companies, during a banner year be so careless of its reputation, as to leave itself open not only to such convictions and penalties, but in the very years when mammoth disasters due to poor maintenance of its plant from Alaska to Texas had already blackened its reputation?

The answer to that question is the forward lean of mammoth corporations, particularly if control of them has been taken over by financial behemoths. In that case this year's earnings represent an ever more daunting challenge that is at once rewarded with options to executives and further stock promotions. Unless the *rate of growth* already attained or merely reported attained is improved upon in the years ahead, the options to company high brass may risk becoming worthless as its stock price crumbles. What such financial corporations are essentially engaged in producing is less particular commodities or services, than a financial multiplier, a rate of growth expressed as a derivative of a higher order, or the proper upwardly pointed graph for the mathematically less literate mega-financiers. Otherwise it would make no sense for one of the world's greatest corporations to rob its customers blind, and at the same time skimp on basic maintenance of its plant. And when finally this forward lean threatens to topple over at the very edge of the cliff, there is always the military option to be exploited.

W. Krehm

lying about their results or were taking large risks not fully disclosed. But [of these] investors were oblivious.

"Consider how banks make money. They pay low rates on short-term loans and charge higher rates on long-term loans. So they love what are known as positively sloped yield curves. And they like to see big credit spreads, where risky borrowers are charged much more than safe ones. Put them together, and banks should clean up.

"By that light nothing was going right in 2006 and early this year. The yield curve was inverted, or at least flat. And credit spreads were at historic lows. Risky loans, whether to subprime mortgage borrowers or junk-rated corporations, were readily available at rates that seemed to assume there was only the slightest risk of default.

"And yet the bank stocks were buoyant, and so were expected profits. Instead of being suspicious, many analysts believed that banks had found a new way to prosper. Making a loan and keeping it on the balance sheet until it was repaid, was so old-fashioned. It was far better to collect fees for arranging transactions and passing the risk on to others. We did not ask why passing on risks should be so profitable to the risk-passers.

"In reality it was not.

"In recent weeks we have learned of many risks the banks kept. Not only did we not understand them, but there is every indication that senior management did not either.

"Consider 'liquidity puts.'

"Don't be embarrassed if you have no idea of what I am talking about. In a fascinating article in *Fortune* Carol Loomis quotes Robert Rubin, now chairman of Citigroup, as saying that he had never heard of them until this summer.

"What are they? Banks put together Collateralized Debt Obligations (CDOs), many of which held subprime mortgage loans as assets. The CDOs were financed by issuing their own securities, and the risk of mortgage defaults seemed to pass to the people who bought the securities."

Sales with Strings Attached

"But we now learn that some banks also handed out liquidity puts, giving buyers of CDO securities the right to sell them back to the bank if there was no other market for them. That risk may have seemed slight when the securitization market was booming. But now the banks are being forced to buy back securities for more than they are worth." With such a put in existence, I don't understand how the banks could get original loans off their balance sheets. How could they claim they sold something if they could be forced to buy it back? It will be interesting to see if the Securities and Exchange Commission challenges the accounting."

Indeed it would, and while the SEC is at it they might check on the statistic published by the Secretary of Commerce that since January 1996, has the finally noted that the government has very substantial amounts of depreciated physical investments listed under this misleading heading of "Savings" which implies highly liquid form of these assets.

I can think of no other purpose for the use of a heading so misleading, and would argue what should be obvious – particularly to Mr. Rubin who was highly aware and up to a point very positively in this area of directing attention to the ignored government assets, but stopped short of going public with the entire crucial fact. There is accountancy, and there is non- or anti-accountancy. The first is essential for appraising not only the health of a bank but of our economic system, and of society as a whole. On the latter there should be nothing than the truth made available to the public. Short of that, we are living under an increasingly defective democracy, that ends up serving private interest to the detriment of society as a whole.

But let us rejoin *The New York Times* columnist: "But even if the accounting was completely proper, it was not very informative. It does not appear that any banks chose to mention the puts to investors before this month. Citibank had billions of dollars of them, and in the new quarterly report from Bank of America, we learn that it had \$2.1 billion of such puts on its books at the end of 2006, a figure that rose to \$10 billion by the end of September.

"In other words, as the subprime market was starting to falter early this year, the bank stepped up the issuance of such puts. Presumably, this was necessary to sell the 'paper.' This week Bank of America announced a \$3 billion write-off; a large part of it came from these puts.

"There were a lot of other funny ways to bolster profits, like specialized investment vehicles, or SIVs."

One might think that the author-dreamers would shy away from the term "vehicle," since it could remind folks of the difficulties of the auto industry, but it would seem that our banks are not being left behind even in that respect.

If Everybody Believed You Had Capital, You Didn't Need Any

Of SIVs Andrew Pollack has this to say: "These creatures (SIVs) bought those CDO securities, paying for them with money borrowed in the commercial money market. Just like banks, the SIVs borrowed short and lent long. The spreads might be thin, but they could employ leverage to make narrow margins go a long way. The SIVs did not have much capital, but so long as everyone believed in CDOs, they did not need it. The banks that had set up the vehicles took no continuing interest in them so they also vanished from any balance sheet that investors could see. Now they are costing bank money to prop up."

I must apologize to our readers for taking so long to fully clarify the matter, but they have waited so long to find out what precisely was ailing our banks, that anything but the entire story would be an evasion. It is just such skipping of the crucial detail that marred the brilliance of Robert Rubin, and all others who leave what could become crucial details that hide the point at which the perversion of maturing economic democracies that existed in many developed countries until the deregulation and globalization of our economies took over.

We cannot take leave of Andrew Pollack without noting the still more important vistas that he alludes to in his final paragraphs: "The most important duty of the Federal Reserve is to preserve the health of the banking system. In the early 1990s, after the last big crisis, it engineered a steep yield curve for years, helping banks to recover. When the smoke clears, the Fed will try to do that again, even if it means significantly higher longer-term interest rates.

"Higher long-term rates are not what either the debt-laden consumers in the depressed housing industry really need, of course. But such trade-offs are what come when big risks are taken, and ignored for too long."

The greatest of all such risks was the deregulation and globalization of a banking system that had once before brought us the Dreadful Thirties without which WWII would not have occurred. Partial fact, with crucial details suppressed – the art of keeping crucial details off balance sheets – unbalances the world and sets us up for ever greater disaster.

William Krehm

Bright and Shiny Stage Lights Turn On to Embarrass Canada's Minority Tory Government

There were lingering questions to ask, but no one except a few minority activists without seats in Parliament ever asked them. How our chartered banks managed to get bailed out at our taxpayers' expense from their real estate mortgage binge in the 1980s, from the major losses they had suffered from having been allowed to invade the other "financial pillars" – stock brokerages, real estate mortgage companies, and insurance, from which they had been excluded during the depression. Had they been asked in Parliament, we would not now be in the midst of a subprime mortgage crisis, that has worked its way into the very guts of our banking system. And now that question never asked in Parliament has risen like a ghost from the grave, to put the unasked and unanswered questions on the table in a way that should make it hard to avoid answering.

Banks Extend their Reach

The current minority government of Stephen Harper is a party formed by the unification of the Progressive Conservative Party and the Reform Party. It was under the premiership of Brian Mulroney in 1988 to 1991 that the legislation was passed that not only bailed the banks out from their speculative binges made possible by the scrapping of the legislation adopted during the Depression preventing the banks from acquiring any interest in the other "financial pillars." The reason – it was the banks taking over the other financial pillars, and applying the banking multiplier to the cash reserves that these non-banking financial institutions held for the needs of their own business, that brought on the gambles that led to the bank crash of 1929 and a decade of Depression and from there directly into WWII. By being forced to stick to banking, the banks were able to recover. By the end of the war, they were impatient to be deregulated once again to resume their speculative games. By 1980 they were accordingly in the soup again. They had lost their capital, and stood in need of a bailout.

This came in two stages. In 1988, the Bank for International Settlements – a sort of central bankers' club from which elected officials were barred – issued its *Risk-Based Bank Capital Requirements* that declared the debt of advanced countries "risk-free" (as in subprime mortgages of more recent date) and hence requiring no down-payments for banks to load up with. All they needed to do was acquire the bonds and clip the coupons. As a result the Canadian government quadrupled its borrowing from the chartered banks, and reduced its borrowing from the Bank of Canada. And on that private-held bank debt the central bank pushed up interest rates to screeching heights, supposedly to "lick inflation." But that was the merest beginning.

Up to 1991 the Bank of Canada had a gentler alternative to supplement or to use instead of the higher benchmark interest rates that it sets for overnight lending between banks or for direct loans from the central banks itself. In this way the banks were able to finance the reserves they were obliged to hold with the central bank, as a percentage of the deposits that they took in from the public. That allowed an alternative to higher interest rates if it wished to "cool off" the economy – it needed only to raise the reserve acquirement and that would restrict the loans that the banks could make. Or if it wished to stimulate a lagging economy it would broaden the banks' lending to the public, by reducing the statutory reserves. On these reserves the banks were paid no interest – not only did that hark back to the seigniorage of the ancestral monarch, and the profit he made on his monopoly in coining precious metals, but it provided the government with interest-free funds. For the interest paid to the central bank on loans the government obtained from it came back to it as dividends. For in 1938, it had bought out 12,000 shareholders at a good profit. Obviously the banks, who had lost much or all their capital, preferred that the government borrow from them rather from its own bank.

And, by the middle of the 1980s, the borrowing of the federal government from the central bank had fallen from some 22% of its debt to a mere 5% or so. To compensate the federal government from this rapidly growing expense, social programs were downloaded from the central government to the provinces without adequate funds to look after them. The provinces passed on the compliment to the municipalities. That is the origin of the plight of municipalities across the land today.

A Stubborn Detail

Those who tried understand what had hit the land, were puzzled by a stubborn detail. Canada was bending its institutions and transferring wealth to its banks far more massively than other lands, without apparent reason. Thus, though the deregulation essentially blew in from the United States, how did it happen that the United States had never nationalized the Fed as Canada had done its central bank in 1938? Yet quite gratuitously it would seem did Canada abolish the statutory reserves outright, while the United States reduced them drastically – placing the portion of the deposits that the member banks held interest-free with the Fed only during banking hours, while shifting them to non-reservable accounts that earned interest when the banking system closed its doors. It was policy of the International Monetary Fund to require of any country receiving its assistance, to do away with its statutory reserves. Canada had at no time sought assistance from the IMF. Why then did it end reserves at all?

There was a hint of what may have been afoot when in drawing up the Canadian Constitution in 1982, Prime Minister Brian Mulroney had tried putting into the Constitution both zero inflation and the independence of the nationalized Bank of Canada from the government. However, his own Caucus of the House of Commons Finance Committee voted down the draft proposal. But what had led Mulroney to even attempt putting these clauses into the Constitution of the land? Was there more than met the eye in the Mulroney's tendency to overshoot the mark? And, indeed, there were versions afoot that Mulroney was doing so for a financial consideration. The Royal Canadian Mounted Police even investigated his relationship with a German-Canadian Karlheinz Schreiber, who claimed to have paid Mulroney $300,000 for his help in obtaining airplane contracts for which Schreiber claimed to have delivered $300,000 for his help. Because that investigation led nowhere, the Canadian Government even paid Mr. Mulroney – by then retired from the government – just over $2 million in compensation.

However, in *The Globe and Mail* (10/11, "Harper orders Mulroney probe" by Daniel Leblanc, Ottawa, and Greg McArthur, Toronto) informed the land that Prime Minister Stephen Harper "moved in to protect the integrity of the office of the Prime Minister and announced that yesterday a yet unnamed neutral adviser will look at Brian Mulroney's cash dealings with a lobbyist and decide whether they warrant a public enquiry.

"The PM dropped his late-afternoon bombshell after government lawyers met to discuss unproven allegations revealed in a sworn affidavit that Karlheinz Schreiber tabled in court two days ago and that *The Globe and Mail* published yesterday.

"Mr. Harper had offered his full support to Mr. Mulroney a week ago, but changed course after Mr. Schreiber claimed he and Mr. Mulroney made plans for a $300,000 deal while the latter was still prime minister in 1992. Mr. Harper also expressed surprise that there was a passing reference to his name in the affidavit."

Protecting the Prime Ministerial Office

"He said his priority was to protect the prime ministerial office and ordered Conservatives to distance themselves from Mr. Mulroney for now.

"'I have not discussed this course of action with Mr. Mulroney, and I think it will be incumbent upon myself and also upon members of the government not to have dealings with Mr. Mulroney until this issue is resolved,' Mr. Harper said.

"The allegations do touch upon Mr. Mulroney's term of office, which is why we believe we can't ignore the allegation."

"In a statement released last night, Mr. Mulroney said, 'I acknowledge the appointment of an independent and impartial third party to review the allegations. I will cooperate fully with the person appointed."

W. Krehm

On Washington's Advice to China

The rivalry of the United States with China, in the light of its increasing dependence on China to keep its Globalized and Deregulated system functioning, promises to lead to bizarre results.

Take as one of many examples the article in *The Globe and Mail* (24/10, "If an economic bubble bursts in China will anyone notice?" by Marcus Gee, Asia Pacific): "China in late 2009 has all the marks of a bubble economy. Construction cranes clutter the skylines of booming Chinese cities, Housing prices in Shanghai have doubled.

"The main index of the Shanghai stock exchange has just passed 6,000 – up more than fivefold in two years. Stock values of leading Chinese companies have soared high beyond that last week and passed General Electric to become the world's second biggest company by market valuation. China now has more companies worth more than $200 billion (US) than any other nation, a remarkable feat for what, for all its successes, is still a developing country.

"China has eight companies in the world's top 20 by market value, compared with seven for the US, four for Western Europe, and one for Russia. That makes no real sense, and it can't help bring to mind memories of Japan in 1989, just before its bubble burst, had 14 companies in the top 20 back then.

"But what looks like a bubble is not always a bubble. China's markets and asset values could go on rising for some time before they burst, just as the US markets did after the US Federal Reserve Board chairman Alan Greenspan issued his famous warning about 'irrational exuberance' in the midst of the dot com run-up in the 1990s.

"True, China looks extraordinarily bubbly at the moment. Inflation hit 6.5% in August, the highest in 11 years. Economic growth reached 11.9% annually, the highest in 12 years. China's trade surplus of $115 billion in the first half of the year was 85% higher than it was a year earlier.

"Stories circulate of peasants and consumers investing their life savings just to get on the stock market bandwagon, a sign surely of the impending pop.

"Or is it? The run-up on the Shanghai Exchange is still smaller than that the rise in the Tokyo Exchange in the 1980s and on the NASDAQ Index the later 1990s. What is more, it follows a long decline in the Chinese stocks. Before beginning their remarkable ascent, share prices actually fell by more than half from 2001 to 2005.

"Now consider housing prices. The 30% price rise there since 2002 is considerably less than the increase than the 46% run-up in the US. Economist Andy Xie, writing in London's *Financial Times*, notes that the total value of China's residential properties is 1.7 times the gross domestic product, compared with 4.5 in 1989 in Japan and 7.5 in Hong Kong in 1987 before property markets went bust."

This should certainly warn us that China as a nation has a great deal of catching -up to do even with other leading Asiatic countries. Trying to persuade China to restrain its market boom, as Washington above all does, can only mean one thing – raise interest rates steeply. For Washington and the Bank for International Settlements, as well as the IMF recognize no other way of restraining a boom than to raise interest rates. The statutory reserves that did provide an alternative to the financial speculative activities had two other methods that governments could rely on.

Under the American *Banking Act,* brought in by the US to deal with the collapse of its own in banks in 1933 and which was substantially copied throughout much of the non-Communist world, these statutory reserves required that the commercial banks deposit with the central bank anywhere from 3% to as much 12% of the deposits, altering the ratio of the statutory reserves to the deposits that covered these statutory reserves, increasing or lowering the ratio of effectiveness of statutory reserves in encouraging further financing by banks or discouraging it.

This provided them an alternative to interest rates. With the near total abolition of the statutory reserves throughout the world, the only means that remains of combating what may be totally mistaken for "inflation." but which up to 1996 ignored all government investment in both physical and human capital by governments throughout the non-Communist world. and since 1996 of its total investment at the time in physical capital. For until that date the US and the BIS while amortizing the borrowing to finance such investment, wrote off the actual assets that resulted -buildings, roads, building in a single year. This, of course, has given a tremendous boost to the attractiveness of privatization of government assets – especially in the areas of historic buildings and toll roads.

W.K.

The New Thinking of What the Real Costs and Causes of Planet-Warming Might Be

Mathematics misused can be no less lethal than arsenic. And if it is above all a government that misuses maths in this way, the destructive capacity of even the simplest arithmetical blunder can threaten not only a nation, but even the survival of human kind. Our own government has provided us with an example of the irresponsible use of grocery arithmetic to such effect.

Neither Canadians nor most other people across the planet will have overlooked the erratic weather which has been associated with the warming of our planet, probably due to the release of greenhouse gases, such as carbon dioxide. For years most corporations have resisted limiting their consumption of CO_2-producing gases, arguing that there is no certainty that this and no other factors might be responsible for the abnormal planet warming. True enough, but there is a double answer to that objection. Let us grant for argument's sake that our unusual weather patterns might be due to some other contributing cause than from CO_2 and other greenhouse gases entrapping the excess heat produced by preventing its escape into outer space.

It is enough that a *high probability* exists of that and hence those who hold that the proof to date has not been absolute, would still have every reason to support and help organize ways of controlling the amount of greenhouse gasses produced, as *insurance* against the growing possibility of greenhouse gas creation being just a major cause of our planet warming. After all we all are compelled to take out insurance against automobile accidents if we drive cars, even when there is a serious likelihood that an accident may never happen. If we waited until an accident actually happened, it would be too late to find an insurance company dotty enough to issue a policy retrospectively. The other class of measures to deal with the possibility that other factors may be involved, is for scientists to continue studying other possible contributing factors that may be controlled.

But that is not the way of most governments, and particularly that of our current federal government in Canada. Canada has suddenly been catapulted into a major role as an oil producer because of the approaching exhaustion of conventional oil fields. For this has suddenly put our oil sands in Northern Alberta, where a heavy bituminal petroleum is in the limelight as a potentially major source of petroleum. However, the processes of bringing this to market refined for use as a transport and heating fuel is also a highly complicated subject. It can hardly be covered by the old formula that allowed corporations that improved their handling of hot-house gases better than the prescribed extent to sell their shortfall in allowed atmospheric pollution to a corporation anywhere that had not fulfilled its own obligation. That formula, applied for years because it conformed with the belief that leaving all our problems to the free market to take care of. In fact it didn't. The same amount of "excess" pollution control would not have the same effect in different parts of the world. Besides it blunts the point that nobody should be profiting from polluting the environment. Nor would seeking such profit lead to the most useful application of clean-up measures.

No "Efficiency" in Allowing an Increased Total Hothouse Pollution

Our Prime Minister has even improved on this simple-minded market formula. Instead of just rewarding the Canadian developers of the Oil Sands with trading rights for their anti-pollutant measures, our PM Stephen Harper, has proposed that oil companies operating in the Oil Sands shall be granted trading rights for greater "efficiency" in keeping down pollution per unit quantity of oil produced. *That would suit the oil operators fine, but would add to rather than take away the total amount of pollution directed and transferred by trading to any other parts of the world.* The assumption is that the market always knows better.

About such things the market is essentially in the dark. It is the mass of citizens with no special interest in oil profits, but a survival interest in air, that will make possible a healthier existence for man and his planet.

The New York Times (07/011, "The Carbon Calculus" by Matthew Wald) informs us that "A change is in the works that could go a long way toward making alternate energy less alternative, and more attractive to consumers and businesses. It is not a technological fix from some solar-cell laboratory, or some wind-turbine researcher in Colorado. Rather, the change could come from Washington, if Congress does what it has talked about and puts a price tag on greenhouse-tag emissions. Suddenly the carbon content of the fuel, of how much carbon dioxide is produced per unit of energy would be as important as what the fuel costs. In fact it might largely redefine what the real cost of fuel might be.

"That might shake up the economics of energy, handicapping some fuels and favouring others. Those that produce heavy emissions, like coal and oil, would look much worse. And some – like sunlight, wind, uranium, and even corn stalks and trash as well as natural gas – could probably look much better. 'Carbon-negative' fuels that take carbon dioxide out of the atmosphere as they are made, might even become feasible.

"Carbon dioxide is what economists call an 'externality,' something that imposes a cost on somebody other than the manufacturer. At some point, the thinking goes, Congress will force industries to pay those costs, either with a tax or a cap-and-trade system in which allowances will cost money. The consensus in the energy business is that lawmakers will come up with a charge that could start at $10 per metric ton or more.

"On Thursday, a Senate subcommittee approved a bill to establish a cap-and-trade system for carbon dioxide, and the Democratic leadership is eager to have the Senate pass it by year's end. But prospects in the House are less certain.

"Some companies are already counting on paying such a bill. At $10 per metric ton, the impact is minimal. But at $50 a ton. the cost of a kilowatt-hour produced by coal goes from about 5.7 cents to about 10 cents. Wind power at present isn't competitive, according to the institute's calculation, but it becomes competitive when carbon dioxide costs $25 a ton. Nuclear energy, with negligible carbon dioxide emissions looks sensible at a small carbon charge.

The new calculus of energy would not be limited to electricity. Like a kilowatt-hour, a gallon of ethanol is a commodity. But its impact on the environment depends on how it is made. For example, Ranger Fuels, of Denver, plans to open a plant in Superton, GA, next year to make ethanol from pine tree waste. About 25% of the tree cannot go to a lumber or paper mill, the company says, and is usually left behind when the forest is clear-cut. If it is burned it produces carbon dioxide. If it rots, it produces methane, an even more potent greenhouse gas.

“Range has a thermochemical method for turning the waste – bark, cones, treetops, needles and small branches – into ethanol. But the economics could vary if Range got credit for using material that was going to turn into a greenhouse gas anyway,

“In contrast, corn ethanol is made using natural gas or coal that also contains carbon that would have stayed in the ground if not for the ethanol manufacture. One new approach to ethanol uses algae. In Arizona a utility is testing a process to fertilize algae with carbon dioxide captured from an adjacent power plant. The algae can be grown and processed into fuel.”

The Unused Bounty of Algae

“As carbon dioxide fees are imposed, these things become more and more competitive, Algae, because of its ability to capture carbon, have a bigger potential than anything else for being ‘carbon neutral.’ Such materials capture and lock up carbon, Some refer to the carbon it locks up and keeps out of mischief as ‘closet carbon.’

“Meanwhile, sugar producers in Brazil are arguing that the ethanol they produce should be able to be imported without the stiff tariffs it now faces. Each gallon of sugar-cane ethanol results in 10% as much CO_2. Some researchers think that there should be products that are carbon-negative. Two papers discuss using renewable energy to displace fossil-fuel and to remove carbon from the environment.

“One is built on the 80-year-old technique of making liquid motor fuel from a gas consisting of hydrogen and carbon monoxide. The Nazis pioneered the technique in the 1930s, making the gas, called ‘synthesis’ gas, made from coal. Some companies in the US would like to revive it, again using coal. But the ‘synfuel’ has more than a closet full of coal. It produces about twice as much carbon dioxide as ordinary oil does, considering the carbon dioxide released during production.

“But synthesis gas can also be made from biomass – wood chips, corn stalks or the paper in garbage. Getting synthesis gas in that way is carbon neutral since next year’s production will come from new trees or agricultural waste, which gets its carbon from the atmosphere.

“At Princeton, however, Robert H. Williams, a physicist, is working on carbon-negative bioenergy in which the carbon monoxide is burned for heat to drive the process but the resulting carbon dioxide is captured chemically, pressurized into a liquid, and pumped underground. If you use plants to make syngas and capture the carbon dioxide, the carbon dioxide is not a byproduct, but a co-product.

“The invisible hand of carbon affects even building sites. Michael H. Deane, operations manager for sustainable construction at Turner Construction, said that companies building buildings offices are looking at sites for characteristics that hardly mattered before.

“‘You can set a building into a hillside, so you can take advantage of the existing mass of the hillside,’ he said. The ambient temperature of the dirt is 55 degrees, winter and summer, which can help with heating and cooling. Sites are now evaluated for solar orientation and prevailing winds, both of which can affect energy use.”

There is then a whole world of new concepts shaping on what the true costs of carbon consumption might be.

W.K.

Coming Clean — Up to a Point

The New York Times (25/11, “Payload: Taking Aim at Corporate Bribery” by Nelson D. Schwartz and Lowell Bergman) reports: “Late last month five jumbo jets from Riyadh touched down at Heathrow Airport in London. They brought with them 13 members of the Saudi royal family, including King Abdullah and his retainers – and controversy. Over the last four years, the British government has been dogged by criticism of its relationship with Saudi Arabia, Britain’s biggest trading partner in the Middle East.

“The same visit, the first by a Saudi monarch in 20 years, was no exception, with much of the storm centering on controversial financial ties linking the British military contracting giant, BAE Systems, to Downing Street and the desert kingdom. The leader of one major British political party boycotted King Abdullah’s visit while protesters turned out for the ceremonial carriage ride to Buckingham Palace.

“Much of the debate turns on the fact that BAE made billions of dollars in clandestine and questionable payments to Saudi royals over the last 20 years as part of an $80 billion contract to supply the kingdom with advanced fighter jets and other military hardware. While the investigation of BAE’s business practices has followed a circuitous path in Britain, it has recently gained independent momentum in the US, where the Justice Department is now investigating the company.

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Bribery and Money Laundering?

“BAE generates nearly half its revenue in the US, and it recently acquired a major supplier of armored Humvees used by American forces in Iraq. American officials, who were granted anonymity because they were not authorized to speak publicly about the matter, said the Justice Department is examining whether BAE violated domestic laws banning international bribery and money laundering. Accounts in Switzerland, the Caribbean and elsewhere are involved and, like Britain, the US has a strategic relationship with the Saudis that the investigation threatens.

“Although the cast of players in the BAE story is unusually broad – it includes Saudi royals like Prince Bundar bin Sultan, the kingdom’s former ambassador to the US. as well as Tony Blair, the former British prime minister – the investigation is but one of a bounty of cases that the Justice Department recently started under a once-obscure law called the *Foreign Corrupt Practices Act* or FCPA.

BAE and the Saudis have openly acknowledged the payment at the center of the investigation, deny any wrongdoing and say that the payments were known to the British and Saudi governments. ‘We are aware of the US DOJ investigation and we are fully cooperating,’ a BAE spokeswoman said. 'As it is an ongoing investigation, we cannot comment any further.' While the BAE investigation apparently ran aground in Britain, it has gained enough interest in the US to cause some of those in the middle of it to secure high-profile legal advisers. Prince Bandar, a confidant of the Bush family, recently retained the former Federal Bureau of Investigation director, Louis J. Freeh, as well as one of the fathers of the FCPA, the retired federal judge, Stanley Sporkin, to represent him.

"'There have been no charges laid,' Mr. Freeh said in an interview. 'The prince denies any impropriety and violating any statutes in the US or the UK.'"

Crumbling Institutions Impossible to Replace with Private Virtues

"The revelation that British investigators had discovered that BAE had deposited $2 billion in payments into Prince Bandar's Washington bank account led the Justice Department to enter what analysts describe as the highest-profile FCPA case to date. Passed by Congress three decades ago in the wake of Watergate, it is only in the last five years that the FCPA has become a powerful tool for prosecuting domestic and overseas companies suspected of bribing foreign officials to secure business.'

Then comes a most revealing couple of paragraphs: "Justice Department officials estimate that there are about 60 such cases under investigation or prosecution in the US, with a new 5-member FBI team dedicated to examining violations of the Act. According to the Organization for Economic Cooperation and Development, a group based in Paris that represents 30 industrialized countries, there are now more than 150 prosecutions or investigations worldwide involving possible bribery of government officials for commercial gain.

"While law enforcement officials and governments in disparate jurisdictions once hesitated to work together to combat corporate fraud, graft has come to be seen as such a severe impediment to global economic growth, that cooperation is becoming more frequent."

When institutions become increasingly curtailed and unstable, with a smaller minority grossly overreaching a deeply underprivileged majority of a given society, the net outcome of such a process is that institutions become increasingly challenged by individuals' corruption and crime. The built-in stability of the institutions accordingly counts for less in maintaining law and a relic of justice. And for the purpose a greater responsibility falls on the citizens' individual virtues, to the extent that they may exist. The initiatives to contain corruption in government contracts is an instance of this.

And closely related to this, there is also a growing readiness to reach for military options. The readiness of governments to seek military solutions for problems that they were unable to handle in a peaceful way can be seen contributing to a more corrupt and law-breaking society, less able to depend on individuals' virtues that are hard put to replace its crumbling institutions.

W.K.

When Large Corporations Play Solitaire

You may believe that the subprime scandal will effect only gambling banks who have loaded up with syndicated debt diced and packaged to "manage risk." But "managing risk" is the elusive goal of every gambler, and these stock market gambles go on from one area of the economy to the other until it will take years to sort them out. For the "sorting out," in fact, the government is likely to step in and bail out what portion of the badly prepared mortgage with the greater "efficiency" of the mortgage company's agents replaced the examination of credit and tax records.

This basic birthmark of a card game for endlessly big stakes crops up all over. The latest can be found in *The Wall Street Journal* (27/11, "Big Buybacks Begin to Haunt Firms" by Peter A. McKay): "Driven by billions of dollars in share buybacks, record-setting buyouts and a wave of mergers, the amount of stock in the market shrank by hundreds of billions of dollars in share buybacks, record-setting buyouts and a wave of mergers, the amount of stock in the market shrank by hundreds of billions of dollars in the past four years.

"With the supply of stock down and demand strong, the market rallied. However, now as the market slows and credit buckles, high-profile companies are cutting back on buy-backs, and some wish they held on to the cash they gave back to shareholders.

"'In an environment like this, stock buybacks take second place,' said James Dimon, CEO, J.P. Morgan Chase & Co., in a conference call last month.

"Yesterday, shares of Freddie Mac fell 29% on the word that the mortgage company may halve its dividend and seek a capital infusion amid a record loss. Freddie might not be in this position if it hadn't bought back at least $1 billion of common stock and replaced it with preferred shares. Fannie Mae, the largest US house-funding company, has tapped the market more recently, raising $1.5 billion in less tan two months by selling preferred stock. Fannie shares fell 25% yesterday and are at their lowest level since May 1996.

"In recent weeks, Countrywide Financial Corporation, which spent $2.4 billion in the past year to repurchase its shares, was forced to resell a chunk of its stock to raise money. Office Depot Inc., which bought back 5.7 million shares at an average price of $35 a share, said on its earnings call yesterday said that it would like to buy its shares back at the current price of $17.49M but can't. Office Depot fell 7% yesterday.'

"Home Depot Inc. said it will delay the rest of its massive stock buyback plan, while investors in Citigroup Inc. have turned nervous about the health of the bank's balance sheet and capital levels, prompting management to say it isn't in the position to repurchase shares.

"The reversal of the trend exposes a flow in the buy-back strategy – many companies bought high and are selling low.

"From the third quarter of 2002 to the second quarter of this year, more than 1.5 trillion shares have disappeared from the stock market through buybacks, mergers or buyouts, according to the Federal Reserve. The number hit a peak during the second quarter of this year, when non-financial companies retired seasonally adjusted net 192.5 billion shares. Some of the money to buy shares came from credit markets, where companies raised $156.5 billion in the quarter.

"Now some investors worry that dividends and buybacks will go from a positive to a negative position for the market as a slowing economy put pressure on a host of companies. Investors usually embrace buybacks, even if those shares are richly valued, because they typically mean that companies are generating a lot of cash.

W.K.

Under Multiple Pressures Germany Rethinks Immigration Policy

One of the many things that the Globalization and Deregulation imposed by US financial creed has ignored is that immigrant and emigrant tradition may be part of a cultural heritage. There are and have been emigrant cultures that have avoided mingling with the alien tribes whom they conquered.

One of the great European immigrant peoples were the Germanic tribes who came out of the east. The record of their migrations, and the extent of their cultural mixing with the peoples already there, has in recent decades been reconstructed by philologists from place names and from the Germanic diversions or from Latin usages in the modern Romance tongues.

The Franks – a German tribe were good mixers, hence the abundance of German roots and structures in modern French. The Visigoths ("West Goths" in their dialect), a more aristocratic, standoffish tribe that occupied much of the Iberian peninsula avoided too much truck with the Romance-speaking plebs. That not only left the Iberian peninsula more exposed to the invasion of the Muslims from Africa, but a smaller German heritage in the vocabulary and structure of Spanish, Portuguese and Catalan.

The name "Lombardy" in Northern Italy is pure German – with a twist: "Lombard" means and meant "long beard." And the Normans who invaded Britain, Gaul, Iberia and Sicily, and Ireland from multiple directions were "North Men" and left their spoor across Europe from the Mediterranean to the many ruined early medieval castles of Ireland.[1] And so forth.

From this clear evidence the Germans have always been a migrating people, but not necessarily one that encouraged immigration into their own lands.

"Globalization and Deregulation" paid no attention to such inherited cultural traditions, but tried to deduce them from the ever mounting expansion needs of the deregulated financial system that Washington was promoting with the subtlety of a battering ram. A lot of naive, well-meaning people, internationalist on principle, tagged along for a while, assuming that what was borderless and international on ethical grounds was good and better. An international system, however, must be judged not by one trait, but by the full quiver of its defining characteristics.

That it is why John Maynard Keynes, with his keen sense of what was practical, rebuffed pressures for returning to the gold standard and free trade on "principled grounds" with a conclusive, "We send our cookies to the Danes and they send us theirs. Wouldn't it make more sense if we just exchanged recipes? I believe that people should move freely across frontiers, but most of what we consume should be homespun."

Germany Rethinks its Role as a Non-immigrant Nation

Now, yet other factors are tugging Germany to rethink its traditional position as an emigrating people rather than one that has traditionally encouraged immigration into its own land.

The Wall Street Journal (27/08, "Berlin Rethinks Immigration" by Marcus Walker) writes: "Berlin – Germany is taking baby steps to relax its tough restrictions on immigration as growing shortages of skilled labour force many European to compete for migrant workers.

"Complaints from businesses that they can't find enough qualified staff – especially in the engineering sector – are pushing Europe's largest economy to rethink its reluctance to admit foreign workers. Chancellor Angela Merkel said Friday that her cabinet had agreed to let companies hire more engineers from European Union countries in Eastern Europe.

"But Germany plans to keep a lid on the number of Eastern European migrants in other sectors, maintaining restrictions that have been in place since Poland and seven other ex-communist countries joined the EU in 2004. In contrast, other established EU countries such as the UK and Ireland opened their doors wide to workers from the East. The influx of workers is widely judged to have boosted their economies.

"Germany, like many European countries, is torn between the economic case for more immigration and an attachment to the traditional idea of an ethnically homogeneous nation-state. For years German politicians on the left and right have assured voters that Germany wasn't a country of mass immigration – even though the country has gone through periods of letting in millions of foreigners. Even when large numbers of Turks settled in postwar West Germany, most Germans assumed these 'guest workers' would return home.

"But in recent years, immigration has slowed amid bureaucratic restrictions, while an increasing number of Germans are moving abroad. Net immigration to Germany fell to 80,000 in 2005 compared with 270,000 in 2001.

"In contrast, countries including the UK, Ireland and Spain have absorbed huge numbers of immigrants in recent years. Many economists credit this with housing growth and living standards for the native population. Others contend that competition from immigrants depresses wages of lower skilled workers. In the past few years, much of the debate over immigration has focused on how to better integrate immigrants and their children into society. Riots in France and the UK and problems at German schools have highlighted exclusion among social minorities.

"Terrorism by militant Islamists, including the Hamburg students who took part in the September 11th attacks on the US, have made many Europeans distrustful of their Muslim minorities."

However, overhanging the scene is the one-child families resulting from the wife working outside the home, and the increasing life-span of the general population. That is a social setting that goes ill with a declining population of increasing life span.

"European policy-makers also must address illegal immigration. Boatloads of destitute migrants – often smuggled by criminal gangs to Europe's Mediterranean shoreline – are common.

"'By 2015 at the latest, our replacement needs will be bigger than our domestic supply of newly qualified workers,' says Volker Treier, skills analyst of the German Chamber of Industry and Commerce. Pressure for more immigration is compounded by an unexpectedly strong boom in German manufacturing, fueled by surging global demand for capital goods. A survey for the German Economics Ministry by the Cologne Institute for Economic Research found that

German firms were unable to fill 110,000 jobs for lack of qualified candidates. Instead, the government focused on the need to train citizens better for the labour market, which Ms. Markel said was a higher priority than immigration.

"Among the members of Ms. Merkel's cabinet, only Education Minister Ms. Annette Schavan has called for further relaxation rules. 'Improving education and strengthening immigration aren't alternatives, 'she said in June. 'We need both.'"

W.K.

1. Elcock, W.D. (1960). *The Romance Languages* (especially Chapter IV, p. 300). London: Faber & Faber.

PART II: REVIEW OF BOOK BY MORRIS BERMAN, W.W. NORTON & CO., NEW YORK, LONDON, 2006

Dark Ages America: The Final Phase of Empire

In our last issue, I presented to our readers a brief introduction to a remarkable book, *Dark Ages America – The Final Phase of Empire* by Morris Berman. Its overriding concern is the insensitivity of the United States to other cultures, and to deal with his theme the author draws upon many specialties. The first episodes rest largely on the work of great American historians, many of whom grasped the unique role of the mobile Western frontier as crucial means of letting off pressures from unsolved internal problems by directing potential rebels to move West.

The resulting relative immunity to unresolved problems might seem harmless for the Americans themselves. It was far less so for those whom they encountered en route – whether native tribes, or the former Spanish colonies. By making a purely metaphoric left-turn, the United States was able to avoid a more literal one, thus perpetuating its deep rejection even in theory of all revolutions wherever they may occur, with the exception of its own founding event.

A Profound Encounter

The current episode deals with the Americans' encounter with technocracy, which, more than a lyric passing affair, was something that ate deeply into their soul, and insulated it still further from a communal life, and a convincing "narrative of existence." But let me allow the author to tell what he has to say in his own quite unique way.

"The most insightful inquiry into the relationship between technology and the way we live today, at least that I am aware of, is *Technology and the Character of Contemporary Life* (1984) by the American philosopher Albert Borgmann. Borgmann's analysis makes it possible to see that much of globalization, as well as the condition that we have labeled 'liquid modernity,' is the result of an internal logic of technological development that reached its highest point (thus far) in the last few decades of the 20th century. In this sense his approach is a corrective to the common perception of technology as being neutral, a tool, a force for good or evil that can be managed or directed by political or economic institutions. The reality, Borgmann argues, is actually very different: modern technology (stress on the word 'modern') provides a 'characteristic and constraining' pattern to the entire fabric of our lives. Borgmann calls this pattern the 'device pattern.'

"Consider, for example, a stereo system providing music, as opposed to a group of friends who gather at someone's home to play music together. What is going on in each case? The first situation involves a kind of abstraction or concealment. Looking at a record or CD, I have no way of knowing what kind of music it contains. Nor do the speakers resemble the human voice or the strings of a violin. And this, in a nutshell, is the device paradigm, the separation of the commodity, in this case music, from the machinery that produces it.

"The opposite of this is what Borgmann calls a 'focal practice.' For instance, when friends gather to play their musical instruments – that centers and illuminates their lives. In this case the machinery is not separated from the product; it is fully present, and embodies a long tradition of craft, method, and musical literature. It does not separate means and ends. It is fully 'whole' and thus makes us whole. This arrangement, in fact, characterizes a good deal of pre-modern culture. With the device paradigm, on the other hand, the world is transformed in a radical way.

"Let us take heat as a second example. For most of the 19th century, across much of America, if you wanted your house to be warm in the winter, you had to do certain things: cut down a tree, saw and split logs, haul and stack wood, and finally burn the wood in stove. Here, says Borgmann we see the difference between a focal thing and a device. A thing is inseparable from its context, and it provides more than one commodity. Few of us today, of course, would welcome the labour involved in this process, and we appreciate the fact that central heating renders this work unnecessary. But the technological comfort comes with heavy cultural costs. The wood-burning stock, more than just heat; it was also a focus, a hearth. It required different tasks from every member of the family, and marked the seasons. It had its important sensuous dimension as well: the smell of the smoke, or the perspiration you felt in the body as you sawed the wood. All these embodied a way of life."

Device Paradigm vs. Focal Practice

"It is for this reason that the common view of the continuity of technology is a mistake. Yes, man has been a tool-user since the Paleolithic era and, no, technology did not arise with the invention of central heating. But such a view misses the point that the discontinuities are much greater than the continuities. The tools and technologies of traditional cultures are never 'mere' means, they are always woven into the context of human ends. Modern technology (say since 1800), based as it is on the device paradigm, introduced a radical new force into society, on that restructured it from ground up. A similar rupture can be posited for the past fifty or sixty years.

"Our problem is that we need to make a distinction between two kinds of burdens: those of hunger, disease, and backbreaking labour, and those that are ennobling, that are exacted by the demands of community and the standards of human excellence. Fast-food outlets may make life more convenient; they also contribute to the nation-wide epidemic of obesity as well as the disintegration of the family, and they make life a lot more empty. Focal things require discipline and commitment; devices are merely forms of short-lived entertainment. In the 20th century, technology freed us up for more technology; it became its own goal."

There is in those lines a vital thought that we should nourish so that it may nurture society.

William Krehm

And It Took Edward Gibbon Half His Life to Understand the Collapse of the Roman Empire!

All you need do is turn to *The New York Times*, Business Day of 28/11/2007, and you will find a good summation in the article "For Abu Dhabi and Citi, Credit Crisis Drove Deal" by Heather Timmons and Julia Wendigier: "A falling dollar, a growing profile of oil revenues, and an interest in not being overshadowed by neighboring Dubai's increasingly high profile spurred Abu Dhabi to break with its low-profile business tradition and purchase a big $7.5B stake in Citigroup.

"That is the view of analysts, economists and dealmakers who keep an eye on the secretive Abu Dhabi Investment Authority, the largest sovereign fund in the world, with assets estimated at $685 billion (12/3/07). Despite its size, Abu Dhabi's royal family has been largely content to pour money into low-return, low-profile investments – until now.

"But Abu Dhabi, the largest oil producer of the seven city states that comprise the United Arab Emirates, is worried enough about the eroding value of the pile of petrodollars that it appears ready to pursue the big-ticket deals."

There goes by the wayside the Koran's injunction against collecting pure interest. Muslim banks can pay out revenue to passive investors provided that they share some of the risk that the entrepreneur who lends out the money shares with the main entrepreneur. But back to the *Times*: "'With the dollar shrinking, they're watching them depreciate and that's driving their anxiety,' says Marc Ginbsberg, former US ambassador to Morocco, who has worked with companies in other emirates.

"Citigroup's motivations were just as great. The company's shares have dropped sharply since October, when billions of dollars in writedowns first started to mount. Later Citi took another $8 billion charge related to bad subprime mortgage investments, which could wipe out its fourth quarter profit. As a result it offered Abu Dhabi generous terms to get its money.

"Both sides were driven together by the credit crisis that struck the American economy with such force this summer,' Abu Dhabi, like other oil producers, has an interest in making sure that the US economy does not weaken further,' said Mr. Ginsberg.

"And ever since Charles O. Prince III resigned as chairman and chief executive last month, and as Citi's board has searched for a new leader, analysts and investors have renewed calls to dismantle the company.

"Sources close to the deal who did not wish to be quoted, said Abu Dhabi, a long-time Citi client, had been banking to make a play in financial services to take advantage of the market dislocation. They said the emirates had considered buying mortgages or distressed loans.

"But in recent weeks it decided to invest directly in financial institutions. It zeroed in on the idea of making a big investments directly in Citi after Mr. Prince was ousted, those close to the deal say.

"Citi has 14 offices and 4000 employees in the region. The negotiations took place in large part over telephone and video conference before Mr. Michael Klein, who has spent a lot of time in the Persian Gulf region when he ran Citigroup's Europe, Middle East and Africa operation, and was the point person for Citi."

Last Year's Vetoed Port Deal Forgiven

"Given sensitivity to past Arab investments, particularly last year's shorted sale of some American ports to an Abu Dhabi firm, Citigroup officials alerted Congressional leaders in Washington before announcing the deal with sovereign fund. Abu Dhabi's 4.9% stake means that nearly 10% of Citicorp will be controlled by Middle Eastern investors. Prince Walid bin Talai of Saudi Arabia already owns a stake of roughly 5% after bailing out the company in the early 1990s.

"'I spoke to them about it at some length the day before,' said Senator Charles E. Schumer of New York, chairman of the Joint Economic Committee and a senior member of the Senate Banking and Finance Committee, referring to senior Citigroup officials."

Clearly the subprime mortgages, in which no foreign terrorist seems to have a hand, had wrought a greater mess than the threat of terrorism out of Abu Dhabi.

"Abu Dhabi has given assurances in other deals that their deals are driven only by economic considerations, They have lived up to these assurances in the past. But Abu Dhabi's ruling family, headed by Sheik Khalifa bin Zayed al Nahayan, will own the largest individual stake in Citicorp when the deal closes, edging out Saudi Prince Walid.

"Bankers in the Middle East said the sovereign fund had traditionally funneled much of its cash into other big global investment funds, and eschewed large company deals."

These apparently would seem to be judged a time to be careful. It is not hard picturing a day – which may already be here, when Muslim Oil potentates come to consider American subprime mortgages as quite as dangerous as Washington and New York do Muslim terrorists.

However, if you want some reference to the extent to which the American super-empire and all its subtle financial reasoning are stretching what they may have left of optimism the way their "risk management" has worked out, you need only visit the lead editorial of *The Wall Street Journal* of the same day: "The Citi play is being spun as a master counter-strike by Robert Rubin, the chairman of the bank's executive committee. The bank gets a capital infusion without having to cut its dividend, and has only to give up a minority stake while Abu Dhabi gets no seat on the board. Even better from a political point of view, Abu Dhabi will be able to convert shares for no more than a 4.9% share stake, which comes in just below the 5% level that requires approval of the Federal Reserve. Mr. Rubin even seems to have greased the skids on Capitol Hill with New York Senator Chuck Schumer already forgetting his campaign against Dubai Ports World.

"Most important, no one should be under any illusions that Abu Dhabi's investment is a normal commercial transaction." No more in fact than the subprimes were normal commercial mortgages. These are emergency contrivances to get out of previous bailouts of those with dominant political clout, when the politicos and the media are led in trained choruses to intone sheer cover-ups as high economic science.

"Readers of these columns might recall in particular Abu Dhabi's adventures in Beltway banking. It was Sheik Zayed, the father f the current ruler of Abu Dhabi, who owned the infamous Bank of Credit and

Commerce International, or BCCI, whose fraudulent tentacles spanned the globe, including the highest levels of Washington politics a decade ago.

"On the other hand, Sheik Khalifa bin Zayed el Nahayan is not his father – who always maintained that he was a victim of the BCCI fraud himself. And Robert Morgenthau, the Manhattan District Attorney who investigated BCCI tells us that Abu Dhabi 'has been responsible' since BCCI.

"On the other hand the bank was forced to settle for hundreds of millions of dollars for lying to evade American banking laws. Sheik Khalifa once called to inform the State Department that if Mr. Morgenthau indicted anyone in the royal family he would pull his billions out of the US. and make no further investments there."

How that threat must echo down the corridors of power in Washington in this epoch of risk management and subprime mortgages and so much subprime else!

William Krehm

The Limited Prophetic Powers of Market Analysts

It is more than mere liquid assets or assets of any kind, that banks and other financial houses have run out of. What has disappeared to the last drop, but not down the gullets of satisfied clientele, is credibility. *The Globe and Mail* (14/11, "Suddenly, everyone is listening to analysts" by Sinclair Stewart from New York) describes a setting of teeter-totters rather than any moral superiority or profound scholarship. But let me quote my source before you think that I have made this up: "The past fortnight could well be called 'A Nightmare on Wall Street' as one blue-chip firm after another trudged before investors to reveal the grisly aftermath of its flirtation with subprime mortgages.

"And yet, amid the brooding over executive firings and curtailed bonuses, one previously maligned group has experienced a resurgence: the equities analyst. Meredith Whitney of CIBC World Markets furnishes the most obvious example. Her warning about a possible dividend-cut at Citigroup Inc. earlier this month helped to vaporize $369 [US] from stock markets.

"On Monday Citigroup analyst Prashant Bhatia suggested the market had lost faith in E*Trade Financial Corp., and that there could be a 'run on the bank.' Investors fled and the discount broker lost 60% of its value. 'Analysts have new impact, though I think it is because everybody else is trying to establish what the rating agencies are going to do,' said John Coffee, a professor of securities law at Columbia University. 'I think they're doing this in a world that is already on the edge of its seat in a state of near-panic.'

"This corollary between the market's fragile psyche and the increased impact of analysts' recommendations mirrors what happened in the dot com boom, he suggested. The aggressive calls on Citigroup and E*Trade came not long after another financial analyst, Kenneth Bruce at Merrill Lynch, floated the possibility of bankruptcy at Countrywide Financial, instantly erasing of the mortgage lender's already (distressed) stock.

"Forget for a moment that none of these predictions have been borne out, and that E*Trade's stock gained 40% yesterday.

"The fact is that, in a market driven by uncertainty, investors were once again ready to throw their faith behind analyst recommendations. No small feat for a profession that lost ample credibility and many would argue, influence – after a high profile research scandal a few years ago.

"In 2003 several of Wall Street's most powerful brokerages struck settlements with securities regulators, who accused them of issuing tainted research to win lucrative investment banking business."

Analysts Tapping into Prevailing Pessimism

"At the market's peak, some of the most high-profile analysts resembled financial rock stars, and a few minutes on CNBC or another financial program was enough to send a stock soaring.

"Yet these analysts were also tapping into a pervasive optimism on the part of investors, which were already motivated to buy. 'This time they are tapping into a fervent fear,' Prof. Coffee suggested.

"Kent Womack, a former Goldman Sachs executive who is now a finance professor at Dartmouth College's Tuck School of Business, said investors are likely willing to view these negative recommendations by analysts as 'more truthful' than positive ones, which in turn heightens the power these research reports wield in the market. Negative calls don't invoke the same suspicion of bias that plagued the analyst sector amid the last controversy.

"Indeed, Prof. Womack credits some of the remedies spawned by this scandal – stronger Chinese walls between bankers and the research department, a crackdown on confidential discussions between executives and analysts that follow them, and so on – for creating an environment in which analysts are more willing to take on companies with unfavourable reports.

"One of the changes has been that companies can't whisper to their favourite analyst like they used to,' he said. 'It is perfectly logical that the cost of being negative has gone down a lot, in terms of the penalties you're going to pay.'"

The complexity of Wall Street firms may also help explain why investors seem to have a hair-trigger sensitivity to analyst reports amid the current credit environment.

"Many of the charges emanating from the bulge-bracket firms related to collateralized debt obligations, or other elaborate instruments in which debt is pooled together and parceled off to buyers. The banks themselves have had a difficult time gauging their exposure, leaving the analysts as an obvious beacon for confused investors. 'You can be a PhD in derivatives and be hard-pressed to know just what the valuations are,' said Jim Owers, a finance professor at Georgia State University. Of course, so much as investors have clamoured for more transparent and objective research, they're not always pleased when they see the results.

"Ms. Whitney, whose exploits were splashed across business pages in New York, Washington, London and even Sydney, managed to recapture some of the rock-star appeal that vanished from the analyst ranks after its most recent troubles. Yet with this invisibility came death threats from those who didn't appreciate seeing Citigroup lose $15 billion in value over a single day.

"'People are scared to be negative, especially when a company has such a wide holding,' she told the *Times* of London."

All in all, stock analysis is not unlike mining. You learn enough to surmise what lies below which translates into what's ahead. And it is not always there once you get there. If you add conscious distortion of prospects into the mix, it is enough to put you on your knees in prayer.

W.K.

On Honest Men and Honest Institutions

As so often in *The New York Times* (23/11, "Banks Gone Wild") Paul Krugman, has written a great column. Well, as so often with Krugman, an almost good economist what he has written on this occasion as well were better qualified as "an *almost* great column."

But let us move into the meat and potatoes of our problem with it. "'What were they smoking?' "asks the cover of the current issue of *Fortune* magazine. Underneath the headline are photos of recently deposed Wall Street titans with the staggering sums they managed to lose.

"The answer, of course, is that they were high on the usual drug – greed. And they were encouraged to make socially destructive decisions by a system of executive compensation that should have been reformed after Enron and World.com scandals, but wasn't."

That is as close as Krugman approaches the great light, but doesn't stay with it. Instead of concentrating on what went wrong with our institutions, he gets back to what he sees always more comfortable in – personal inadequacies and vices.

"In a direct sense, the carnage on Wall Street is all about the great housing slump.

"This slump was both predictable and predicted. 'These days,' I wrote in August 2005, 'Americans make a living selling each other houses, paid for with money borrowed from the Chinese somehow, that doesn't seem like a sustainable life style.' It wasn't.

"But even as the danger signs multiplied, Wall Street piled into bonds backed by dubious home mortgages. Most of the bad investments now shaking the financial world seem to have been made in the final frenzy of the housing bubble, or even after the bubble began to deflate.

"In fact according *Fortune*, Merrill Lynch made its biggest purchases of bad debt in the first half of this year – after the subprime crisis had become public knowledge.

"The losses suffered by shareholders in Merrill, Citigroup, Bear Stearns and so on are the least of it. Far more important in human terms are the hundreds of thousands if not millions of families lured into mortgage deals they didn't understand, who now face sharp increase in their payments – and, in many cases. the loss of their houses – as their interest rates reset.

"And then there's the collateral damage to the economy. You still hear occasional claims that the subprime fiasco is no big deal. Even though the numbers keep getting bigger – some observers are now talking about $400 billions in losses – these losses are small compared with the total value of financial assets.

"But bad housing investments are crippling financial institutions that play a crucial role in providing credit, by wiping out much of their capital. In a recent report, Goldman Sachs suggested that housing-related losses could force banks and other players to cut lending by as much as $2 trillion – enough to trigger a nasty recession, if it happens quickly. Beyond that there is the pervasive loss of trust, which is like sand thrown in the gears of the financial system.

"How did things go so wrong?

"Part of the answer is that people who should have been alert to the dangers and taken precautionary measures, instead blithely assured Americans that everything was fine, and even encouraged them to take out risky mortgages. Yes, Alan Greenspan, that means you.

"But another part of the answer lies in what hasn't happened to the men on the Fortune cover – namely, they haven't been forced to give back any of the huge paychecks they received before the folly of their decisions became apparent."

When Unlimited Became a Public Virtue

"Around 25 years ago, American business – and the American political system – bought into the idea that greed is good. Executives are lavishly rewarded if the companies they run seem successful; last year the chief executives of Merrill and Citigroup were paid $48 million and $25.6 million, respectively.

"But if the success turns out to have been an illusion, well, they still get to keep the money. Heads they win, tails we lose.

"Not only is this grossly unfair, it encourages bad risk-taking, and sometimes fraud. If an executive can create the appearance of success, even for a couple of years, he will walk away immensely wealthy. Meanwhile the subsequent revelation that the appearances were deceiving is someone else's problem.

"The point is that the subprime crisis and the credit crunch are, in an important sense, the result of our failure to effectively reform corporate governance after the last set of scandals."

But whereas Mr. Krugman has taken a good run in the direction of the real sources of the problem, he fell short with a thud, and didn't arrive at its real essence. That is institutional – the control of parliament, our crucial laws, including the freedom of information in parliament, the media, and our universities has been curtailed to cripple the crucial institution involved, and that in turn has to do with the availability of information to enable our information, educational and parliamentary institutions to function.

Where you have functioning institutions of such categories, the success and survival of our society will depend less on the heroism of individuals and on their virtues. Only functioning democratic institutions – our parliament, our universities, and our media can assure that.

That is why we ought to deal with Mr. Schreiber's information quickly if thoroughly and go on to the real problem of the Mulroney years. Why has the *Bank of Canada Act* – still on our law books – been disregarded when it would give us the institutional tools to restore economic democracy and hence plain democracy. There is no record of subprime mortgages having been explained to parliament or justified by anything in the *Bank of Canada Act*, which is still the disregarded law of the land. What we have there is a violation of our duly adopted institutions, that rewards a violation of our constitution. Restore that to where it was when Mr. Mulroney laid hands on it, and globalization and deregulation of our banks and financial systems will not only be contained but reversed.

Until then you will be trying Mr. Mulroney for his peccadilloes rather than for the major mischief that he did during his period as head of our government.

The institutional aspect of the economy and of some other key institutions has simply disappeared beyond the horizon.

William Krehm

Welcome to the Internet ER

The note from an Ottawa MP requesting that we swap our subscription of *ER* from a paper version to an e-mail copy awakened me to the fact that we have crossed a communication bridge. Not only is the newsletter in print, it is also available in PDF format from our website at www.comer.org.

In the *Globe and Mail* article quoted in our recent correspondence, there is mention that the banking multiplier – the number of times the money our chartered banks lend out the amount of legal tender which used to be about 10 had now reached 30 to 1. That was far too low. For the greater part of a decade until 1998 we used to compile from Bank of Canada figures provided by the Bank of Canada the banking multiplier. We stopped doing so in 1998 when the multiple in question had reached 363.5 (which appears on page 372 of *Meltdown*, vol. 1). It went on to cross 400 before falling back after the economy collapsed and the millennium scare subsided.

We stopped doing the calculation because we ran into a statistical difficulty. We had need of a denominator for our crucial ratio so we improvised one that to begin with moderately understated the multiple. We used the figures for the coin, the government money bills and the very short-term federal securities held by the banks. But these were strictly not reserves. They went to feed the ATMs outside the banks and to meet the request for change and small cash of the clientele. The moment the ATMs failed to respond and the banks refused to cash cheques there would be a run on the banks as though far larger sums were missing. But failing the availability of a denominator our multiplier would swing to infinity and become meaningless. So we abandoned the statistic. Otherwise we are certain that it would by now have touched 1000 or have been close to it. *That is what the subprime mortgage crisis is about.*

But here, too, bad economic theory made its contribution. By the 1960s the banks in the US and Canada were well on the way of casting off the prohibitions that the Rooseveltian legislation had imposed on US banks that were closely followed by central banks throughout much of the world. In the 1980s the US banks took over the Savings and Loans – in essence mortgage trust companies. By the end of that decade the banks had lost most of their capital. And to make them whole again the Bank for International Settlements, which served as war-room for the comeback to deregulation and globalization of the world's banks, brought in two special measures.

In 1988 it sponsored the *Risk-Based Bank Capital Requirements* that declared the debt of developed countries risk-free, and thus requiring no down-payment for banks to acquire. That put the banks in business again, though for several years they paid their depositors next to nothing in interest on their deposits, and charged their borrowers the moon. The spread between the two rates was also intended to refill their coffers, which had been dangerously emptied.

The BIS — A Blind Monopolist

And in 1991 the Bank for International Settlements played a considerable part in designing the phasing out of the statutory reserves in the portion of the deposits that the banks took in from the public that they were obliged to redeposit with the banks and on which they earned no interest in Canada and most other countries. These reserves had as one of their purposes to provide an alternative to the benchmark interest rates that central banks set for banks to charge one another for overnight accommodation to meet their obligations. In this way the benchmark interest rates could be supplemented or even replaced to cool off an overheated economy or stimulate a depressed one. Interest is the primary revenue of money lenders. It has been known to lead to gross exploitation and even the bankrupting of debtors to make them cheap prey. Doing away with the statutory reserves was thus tantamount to empowering the banking system and money-lenders to exploit the country by giving them a monopoly.

What was overlooked, however, was that if you load up the bank with government debt acquired totally leveraged, and then push interest rates into the skies, the value of the banks' preexisting government bond hoards with lower coupons debt falls, and the banks are in trouble again. And that is exactly what happened in Mexico in 1994 and threatened the banking system of the world. President Clinton of the US and his Secretary of the Treasury, came to the rescue by organizing the largest standby fund to that date – $51 billion, of which the US and the IMF each provided $15 billion and Canada $1 billion. It did not have to be used.

However, more important consequences came out of that crisis. Up to then the US and Canadian governments as governments throughout most of the world when they made a capital investment, completely wrote off its asset value on their books in the year in which it was paid for, but the debt incurred to buy or create it was amortized over the assets' likely period of usefulness. Obviously that twisted any serious notion of what was going on in the economy.

Moreover, a higher price level could be due to very different causes. If anybody moves from a town of 20,000, let us say, to New York City, he will not be fool enough to expect his living costs to remain the same. How then can that be expected when humanity makes just such a move?

Here again it was the American Secretary of the Treasury who seems to have devised the solution. For the first time capital investments of the government were treated as such rather than written off in a single year. Carried back to 1959 this brought to light well over one trillion dollars of ignored physical capital assets. And even though they were misrepresented in the Department of Commerce statistics when they started appearing under the heading of savings, which they were not – that amongst economists refers to savings in cash or in short term securities readily converted into cash. However, a wink and a nudge conveyed their real nature to the bond appraisers.

That very necessary introduction of serious accountancy into the books of the US – and after lively arguments between the Canadian Minister of Finance of the day, Paul Martin, and the Auditor General, a similar change was made in Canada. This brought to light a tremendous amount of ignored assets, brought down interest rates and launched North America and the world into the boom that gave President Clinton his second term, and the Western World its high-tech boom. It provided the excess of money that would not be allowed to lie around without yielding revenue. That plethora of money that had to be invested at a good speculative return, provided the background for the subprime mortgage boom that we deal with in several of its aspects in this issue of *Economic Reform*. It is important, therefore, to understand the origins of that flood of money that simply had to be speculatively invested. Unless it is, it is simply not money when speculators take over the economy.

William Krehm