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SUBMISSION TO THE LAKESHORE COUNCIL, JUNE 12, 2006

Time to Hear from our Municipalities

Lakeshore, Ontario, stands in pressing need of a new water plant that will cost $25.9 million. That is a lot of money to borrow from banks especially with interest rates being pushed up once again by the Bank of Canada. Fortunately, there are still in Canada's *Bank of Canada Act*, unused provisions for a cheaper way for municipalities to finance their essential capital projects. Those provisions were used to finance our World II. During its first 22 months 25% of the $1,9 billion raised at home resulted from the Bank of Canada's holding of federal securities, Since the BoC had been nationalized in 1938, the interest paid on these holdings returned substantially to the government as dividends. After the war a vast penniless immigration was absorbed to standards undreamt of before the war by making use of this same device. A baby boom was taken care of. New technologies were introduced And despite all this, by the mid-1970 the proportion of federal debt to the Gross Domestic Product had been reduced from about 160% to the mid 20% range.

How was this done? By using the Bank of Canada to finance capital projects.

The Bank of Canada was founded in 1935 as a private institution with 12,000 shareholders. In 1938, the government of Mackenzie King bought out its shareholders at a good profit. The provinces may also borrow from the Bank of Canada. Municipalities may do so as well, but only with the guarantees of either the federal or provincial governments.

That is still provided in the case of funded debt, i.e., organized as a bond issue, in subsection 18(c) of the Act: "The Bank may buy and sell securities issued or guaranteed by Canada or any province."

"Buy and sell" implies "hold." But it is important to note that for a municipality to borrow requires the guarantee of either a province or the federal government.

In the early 1990s PM Brian Mulroney conducted a campaign to declare the Bank of Canada "independent" of the government, and to put that and the "zero inflation" goal into the country's constitution. Only when the government's own caucus in the Commons Finance Committee joined the others in voting against that motion, was it dropped. That explains why Mulroney and his successors didn't dare mess with the *Bank of Canada Act* again. Today that Act presents a strange anomaly: all sorts of provisions that proved vastly useful in the two decades after the war are still in it, but are never mentioned in Parliament or used. Thus on the supposed independence of the central bank from the government. Subsection 14(2) of the Act reads:

"If, notwithstanding the consultations provided for in subsection (1), there should emerge a difference of opinion between the Minister and the Bank concerning the monetary policy to be followed, the Minister may, after consultation with the Governor and with the approval of the Governor in Council, give the Governor a written directive concerning monetary policy in specific terms and applicable for a specified period, and the Bank shall comply with that directive." That could hardly be clearer.

A further important point. Almost the

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Allen Good's cartoons will return.

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Municipalilties *continued from page 1*

entire interest paid on such loans from the BoC, whether to municipal, provincial or federal government will end up going to the federal government, but not to the two junior levels of government. *For the federal government is the only shareholder of the central bank, and hence receives all its dividends.*

To have the Bank of Canada finance vital capital projects at lower than market and even near-zero interest rates, an agreement would have to be negotiated with the federal government. In return the municipalities could agree to observe federal standards in their capital projects. This would introduce a new dimension for cooperation amongst the various levels of government that is sadly missing.

The Moral Reasons for Ottawa to Return Debt Interest to Municipalities

But beyond that, there are some powerful moral reasons for the federal government agreeing to such arrangements that could be brought to its attention if necessary. Much of the plight of our municipalities today stems from the federal government's repeated deregulations of our banks, *after they had been bailed out from the speculative activities made possible by earlier deregulation.* And whenever this ruinous cycle was repeated, the resulting losses were downloaded by Ottawa onto the provinces, who passed the compliment along to their municipalities. This was usually done by downloading vital social programs without adequate funding to cover them.

Recently certain leaders of the federal Conservative Party have advanced a proposal for confining the federal government to defence, foreign affairs, and little else, and assigning to the provinces these functions taken from the federal government. That sounds like greater autonomy for the provinces, but is in fact an attempt to constitutionalize a situation that is becoming unbearable for many of them.

The banks' losses in speculative activities incompatible with banking were transferred to the taxpayers in two grand strikes.

In 1988 the Bank for International Settlements (BIS) issued its *Risk-Based Capital Requirements* that declared the debt of developed countries "risk-free," thus requiring no additional capital for banks to accumulate. In that way Canadian banks quadrupled their holdings of federal debt four-fold to $80 billion without putting up a penny of their own money. BIS is an organization of central banks that does not encourage anyone but central bankers connected with governments to attend its sessions. It has served as a sort of semi-underground bunker for plotting the comeback of the world's banks from the strict regulation imposed on them during the Depression of the 1930s.

In 1991 over a two-year period the Bank of Canada[1] phased out the statutory reserves that the banks had to redeposit with the central bank and on which they earned no interest. One purpose of those reserves had been to provide the central bank with an alternative policy tool to raising its benchmark interest rates to "cool" an overheated economy or stimulate a recessed one. Moreover, if the central bank paid the banks interest on the reserves, it would cut the central bank's leverage in using this tool. These reserves were conceptually a continuation of the ancestral monarch's monopoly in coining precious metals. Known as *seigniorage*, this gave the federal government more latitude in having the Bank of Canada increase its credit to the government within existing restraints.

At the precise time that the statutory reserves were phased out, the same Bank for International Settlements declared that the fight against inflation, now become synonymous with higher interest rates, had to be intensified until "zero inflation" were attained. One or two percent "inflation" would no longer do but could only, said BIS, lead to hyperinflation such as wiped out the German currency in 1922. My time does not allow me to explain how in a developed economy the price level can go up even when there is no "inflation," i.e., no excess demand over supply.

Instead I will cite another reason why BIS's two top policies of the period were incompatible with each other – something should have been obvious to an organization of central bankers. When interest rates go up the market value of pre-existing bonds falls. And with that the hoards of government bonds that banks had been allowed to take on without putting up a dollar of their own would melt away like ice under a July sun. And that is what happened. First the Mexican banking system had to be nationalized once again not long after having gone through the previous privatization. The international monetary system was hardly less threatened, President Clinton, without even seeking the support of Congress came to the rescue by setting up the largest bailout fund to that date He persuaded the IMF and Canada to join him in putting up the $51 billion US to that end. Yet even so,

the collapse of the Mexican banking system and the Mexican currency still echoed some years later in the East Asian crisis of 1998 followed by the Russian debt default.

If the Lakeshore Council is to achieve the desired Bank of Canada loan for vital capital purposes it must make use of the rest of the suppressed history of the 1990s. President Clinton had an unusually bright Treasury Secretary, Robert Rubin, former head of a leading Wall St. house. He grasped at once that the days of high interest rates were over. since banks desperately needed those bond coupons to replace their lost capital. And he knew a secret way out from that incredible mess.

The Surreptitious Virtuous Deed of President Clinton

Until then governments throughout the world practised "cash accountancy." That is, they wrote off any investment they made entirely in the year when it was made, and entered its value on the asset side of the ledger in year two, at a token $1. But on the liability side the debt incurred to finance the building, bridge, road, or equipment, whatever, was carefully recorded at its still undischarged balance.

Were you to calculate your personal worth by entering the true balance of the mortgage you wrote to buy the house, but the offsetting value of the house it helped buy at $1, you would appear an undischarged bankrupt. You would also end up paying wildly high interest rates on your borrowings because of such bottom lines. It is not hard seeing how such a method of non-accountancy favours the financial over the producing sector of the population and taxpayers in general.

If government capital assets appear on the banks' books at a token dollar, that is a signal to privatize them at a fraction of their real value, and the lucky buyer can then sell it to a public company for its real value. Then the public will end up paying a second time in user fees what it has already paid for in taxation. That allowed government to apply the supposed "profit" in the privatizing transactions to reducing the government debt, and taking the appropriate political bows.

What the Clinton government introduced into the national savings figures beginning with the January 1996 figures of the Bureau of Economic Analysis of the Department of Commerce showed an increase in government "savings." This was a case of a highly virtuous deed done secretly. For properly depreciated values are not "savings" for that term implies "cash" or values easily convertible into cash, and most of the $1.3 trillion of asset value that Clinton retrieved for his books was in bricks and mortar, cement, and steel.

But they still didn't touch an even more important investment – in human capital – education, and hence in health, and social services. In the 1960s Professor Theodore Schultz of Chicago University, on reviewing his own and others' predictions of how long it would take defeated Japan and Germany to recover from the Second World War and regain their prewar export might, reached an epoch-making conclusion: He and his colleagues had been so wrong, because they concentrated on the war's physical destruction, and overlooked that the highly educated, trained and disciplined work forces had come out of the conflict essentially intact. From this he concluded that the most productive of all possible national investments is in human capital. For this he was awarded the so-called Nobel Prize for Economics. Today he is largely forgotten, because it is not what those in power want to hear. However, if you don't build necessary schools, you build jails and penitentiaries, and they do come far dearer. Investment in human capital has long depreciation periods – the children of educated and healthy parents tend to be better educated and healthier.

I understand that you are in need of a couple of new schools in Lakeshore. The suppressed literature on education and human capital investment in general is something that you could use to good effect in working for financing at low or even near-zero rates of financing through the Bank of Canada.

Distorting the Effect of Accrual Accountancy

It took the Canadian Auditor-General until 1999, and then only after many weeks of bitter argument with the Finance Minister, Paul Martin, before a compromise was reached on the introduction of accrual accountancy. A line of previous auditors-general and two Royal Commissions had recommended it decades ago. During the argument, the A-G actually used the expression "cooking the books" referring to the accountancy Ottawa was practising.

Two final points.

The *Bank of Canada Act*[1] is still full of everything needed for you to obtain such financing with a bit of help from other municipalities across the land that it should be possible to convince Ottawa and Toronto that what you propose they owe you and this land. Pick this information up and run with it. Our modest research organization exists to help you.

William Krehm

1. Note: *not* the *Bank of Canada Act.*

Post Script

The Lakeshore Council seemed to need no great convincing. They had been well introduced to the subject by André Marentette, George Crowell and Gordon Coggins, local COMER members. Later on the main street I chanced upon mayor Bob Croft, and he asked how our proposal compared with the financing offered them for the new waterplant. This consisted of a $10.2 million outright grant from the Canada Ontario Municipal Rural Infrastructure Fund. That would certainly relieve the pressure on local finances, but, of course, local citizens, as Ontario and Canadian taxpayers would be tapped for that – though to a lesser extent. The balance of $15.7 million would be made available as a 20-year loan, at about 5%, though the figure would depend on rates at the time of signing the contract with OSIFA, Ontario Strategic Infrastructure Financing Authority. In that the federal government and the Bank of Canada are not even involved. The Ontario agency would be acting as an intermediary between banks and the municipality.

Even if 1% were deducted from BoC financing for overhead of the BoC and the Government and interest before signing would not rise beyond 5%, the difference is 4% compounded over 20 years. Plus, of course, the principle involved in having the federal government return to the municipalities some of the public funds that were lavished on the banks and repeatedly as they were lost in speculative gambles having nothing to do with banking. The municipalities have a perfect case – as is evidenced by what is still in the *Bank of Canada Act*. Besides they would be protecting their future – since speculative finance has increasingly taken over our government. Unless the issue is dealt with, the situation will go from bad to worse. The fact is that low interest rates had been brought in via accrual accountancy. Yet more recently the central bank has resumed its high interest addiction – at a time when the country is involved in military campaigns abroad. That should be a warning of the high cost of not challenging governments when they ignore the laws of the land.❧

Monetary Light for Beating the Heat?

Currently topical concerns over global warming (Al Gore's book and movie, *An Inconvenient Truth*) and controversy over the Kyoto Accord are reinforced by illustrative news items. A recent article in *The New York Times* ("The Not So Good Earth," by David Barboza, June 23, 2006) reported that "a coal mining boom...is devastating large swaths of north China, where some of the nation's richest coal deposits lie. China is the world's largest producer of coal.... [In Shanxi province, which] provides [much of] the fuel that powers China's sizzling economy, thousands of acres of land are sinking because of the ravages of underground coal mining.... [At one locale, residents recounted how] their village was rocked by what everyone thought was an earthquake. The ground shook. The houses trembled. And the earth cracked open. Moreover, coal fires are burning uncontrollably below ground here and through much of northern China, adding to global warming by releasing huge amounts of carbon dioxide into the atmosphere." Other reports blame coal mining for a significant share of desertification in China, and pollution from both its dust storms and industrial smokestacks is reaching North America.

On the same day as the *Times* article, the International Energy Agency announced its finding that oil and electricity consumption across the world could easily be cut by half, with major benefits for the environment, if clean energy technologies that are currently available were applied. "A sustainable energy future is possible, but only if we act urgently and decisively to promote, develop and deploy a full mix of energy technologies.... We have the means, now we need the will." The IEA report was written in response to a request last year from G8 leaders, for discussion this year at St. Petersburg (Rory Mulholland, *Agence France Presse*, June 23, 2006).

The weight of expert opinion, as assembled for example by Al Gore, points strongly to a conclusion that beneficial use of carboniferous fuels has reached a point of no return. It not only diminishes human comfort in several ways, but through its devastation of the biosphere it also threatens our very survival. The dilemma is acute because fossil fuels consumption is the established driver of industry and regarded as indispensable in conventional attitudes toward economic policy. The problem is exquisite, as illustrated in a very interesting small book about the central place occupied by coal in the emergence of the world as we of the twentieth century have known it (Freese, Barbara, *Coal: A Human History*. Cambridge, MA: Perseus Books Group, 2003).

The Coal Industries Feel Threatened

The author describes herself as a former environmental attorney for the state of Minnesota whose interest in her subject grew from "a legal proceeding [by the state] that tried to quantify the impact of its electricity use on global warming. Most of Minnesota's electricity, like that of the US as a whole, comes from coal, so this meant trying to figure out what effect the emissions from our coal-burning power plants would have on the earth's climate.

"When the proceeding began, few realized what an exquisitely sensitive nerve it would touch. Representatives of the nation's coal industry...intervened in our hearing.... They brought in a phalanx of scientists who testified that Minnesota should ignore what the vast majority of their colleagues around the world were saying about climate change and argued instead that the climate was not changing except in small ways we were all going to enjoy.... The industry's aggressive response was fueled by its recognition that climate change threatens its very existence. Climate change is mainly caused by burning fossil fuels – namely, coal, oil, and natural gas – and of these fuels, coal creates the most greenhouse gases for the energy obtained. Today, the United States burns more coal than it ever has, almost all of it to make electricity.

"...Minnesota's decision makers flatly rejected the industry's notion that climate change would be limited to climate improvements.... I was left not only deeply concerned about the changing climate but thoroughly intrigued by the lump of carbon at the center of the storm, this often-overlooked fuel that reveals so much about us and the world we've built. The more I dug, the more I could see that a deep, rich vein of coal runs through human history and underlies many of the hardest decisions our world now faces. Following that vein in the intervening years has taken me far afield – from paleobotany to labor issues, from ancient history to modern geopolitics, and from the massive state-of-the-art power plant a few miles from my home to a primitive little coal mine in Inner Mongolia. This book is the result of that journey."

Freese's account is highly sympathetic to the coal industry insofar as its product has played an essential role in what must be acknowledged as human triumphs. In concluding that the era of coal must be brought to an end, she points to technological alternatives that already show sufficient promise as adequate replacement. And opposition from the coal industry per se is to be expected. The question she does not address is the role played by finance in both propping up the existing industry and obstructing transition to beneficial and sustainable energy supplies. Given the critical role of energy sources to civilization as we know it, this is an important domain for thinking about the role of monetary institutions and policies in economic management. To underscore that assertion, the following conclusions drawn by Freese from her historical exploration are highly thought-provoking.

Our Civilization was Created by the Use of Coal

"We've made a lot of mistakes over the centuries as we've struggled to understand the nature and impact of coal and its smoke. Some thought coal grew underground from seeds or in mines guarded by demons or dragons. Some saw in the mines scientific proof of the biblical flood. Some credited coal with protecting people from the bubonic plague; others accused it of promoting baldness, tooth decay, sordid murders, caustic speech, and fuzzy thinking. More recently, many of us believed we could burn vast amounts of coal indefinitely without disrupting the natural balance of the planet. No doubt we still have much to learn about coal, but at least we've been able to dispel many of the old myths.

"There is, though, at least one truth that was more widely understood in the past than it is today – the critical importance of coal in shaping the fate of nations, and of the world as a whole. Coal transport lured the British to the sea, promoting the nation's growth from a small rural nation into a world-class commercial power. The Royal Navy was kept strong largely to protect the coal convoys; and in war time, it seized

the coal ships and crews to fight its battles, helping Britain rule the seas. Thanks to coal, London grew into a metropolis large enough to become a vital center of commerce and cultural achievement. With an economic, military, and cultural influence far out of proportion to its size, this tiny nation began building a global empire of unprecedented reach, defeating native populations and European rivals such as France and Spain – nations with far more land and people, but far less coal.

"And then there was the industrial revolution – fueled by coal, built around coal-smelted iron, and driven by two key innovations first developed to meet the needs of the coal industry: the steam engine and the railway. Coal alone did not make the industrial revolution happen any more than coal alone made Britain a global superpower, but neither event could have happened without it.

"To grasp the magnitude of coal's global impact, we must try to picture history without the momentous, high-intensity pulse of industrialization that started in Britain and then swept the world. The mainly agrarian world would have stayed in place for decades or centuries longer, with slower technological progress, less material wealth, and more gradual social change. Mass-production capitalism would not have soared to prominence, industrial working classes and places like nineteenth-century Manchester would not have mushroomed, and the *Communist Manifesto* would never have been written. The North might have lost the American Civil War, or it might never have started, and the transformation of the American West would have happened slowly by wagon rather than quickly by rail. The World Wars might never have exploded without the industrial rise of coal-rich Germany. Colonial conquests would have been far less sweeping, dramatically altering the history of all the societies that were dominated by foreign industrial powers, including China's (whose ancient history would have been altered as well). The labor and environmental movements, if they had existed at all, would have taken very different forms. In short, none of the defining and epic struggles of the nineteenth and twentieth centuries would have played out as they did.

"This is not to suggest the world would have been necessarily stable and peaceful, as a glance at our planet's violent pre-industrial history shows. If human progress had been more dependent on harnessing surface energy rather than mineral energy, it's possible, for example, that slavery might have become an even more entrenched evil. And, although our air would have been

Sewing Together the Chopped Off Limbs of the Free Market Model

The news that comes out at us from this deregulated and globalized world can only be described as intimidating.

Under the leadership of good part of the First World against much of the Muslim world, much of the Western already been engaged in serious warfare of well over a decade. That is twice the length of the Second World War, that was won by the allies because the Allied Governments sorted out a few basic fact about their economy – quite apart from the Soviets who for all their immense shortcomings had picked up at least a few basic notions on how to wage peace and war. Though there is no comparison with the degree of firing power actually used – which for its degree of concentration favours the effort of the earlier conflict. However, the indecisiveness of the present conflict as it moves well into its second decade, and the atomic weapons piled up as a reserve in the background are even more disturbing.

Such was my troubled reaction when I opened *The Wall Street Journal* of June 6 and found two prominent reports that I have found it possible to reconcile.

On the front page the article "Dow Falls 1.77% as Fed Chief Adds to Investor Jitters: Fears of Further Rate Rises Grow as Bernanke Pledges Vigilance Against Inflation" by E.S. Browning and Greg Ip, from which I quote:

"A surprisingly frank inflation warning from Federal Reserve Chairman Ben Bernanke stoked fears of further interest-rate increases, adding to investor jitters and knocking the Dow Jones Industrial Average down almost 200 points in its lowest finish since March 9.

"Speaking at an international bankers' conference in Washington, Mr. Bernanke warned that inflation in recent months has been running 'at or above the upper end of the range that many economists, including myself, would consider consistent with price stability.' He said Fed policy makers would remain 'vigilant' to ensure that recent inflation readings don't become the norm."

What hit me between the eyes, is that the closest thing to the financial Czar of the most powerful nation in the world seems to have decided that what to his mind is "inflation" can be repressed with "the one blunt tool" at his disposal – interest rates high enough to "do the job." Let us transfer this mindset to, let us say, year 4 of World War II. The outcome of the war was clear enough for the Bretton Woods Conference to have been held to plan the post-war financial regime. Interest rates at that time were minimal and pegged; prices had been under control since the outbreak of hostilities. Certainly peace and the ability to plan the planet-wide arrangements of the postwar were more clearly in sight than the outcome of the Afghan and Iraq wars. The end of the conflict was better in sight than can be said in the case of today's struggle. And that being so, why is no one in official circles asking why the world is depending on one blunt tool to fight and lick "inflation." ill-defined, certainly not to cover the military efforts in the heavens and on all continents against terrorism? I can mention as a self-evident fact that if in WW II the Allies had depended on the one bunt tool of higher interest rates rather than bringing in price controls, import and exchange controls and countless other restrictions on the free market, by 1944, Adolf Hitler might have been in London if not in Washington planning the postwar financial arrangements rather than the Allies in Bretton Woods.

Note well, I am not proposing price controls to get us over present rough spots that our world is going through. But if Mr. Bernanke is that concerned with "inflation" surely he might have been allowed to draw on what was he was taught about wars and their effect on the price in the undergraduate economics courses he attended. Certainly, a struggle like the one that Washington has picked with the Islamic world that has gone on for far longer than a decade, cannot be without effect on our price level. Perhaps our American cousins could consider going back to the 1935 *Bank Act* that provided statutory reserves to deal with inflationary pressures.

William Krehm

cleaner and our climate less threatened, our forests and wilderness areas might have been more widely depleted. The pressure on the land would have been far greater because it would have been drawn upon for fuel as well as for food. No doubt, eventually somebody would have figured out how to turn heat into mechanical motion, inventing the steam engine or something like it, and the pressure on the remaining forests would have intensified. In such a world, heavily wooded nations like Sweden might have achieved global prominence. Oil and natural gas resources would have been tapped, too, but probably much later than they actually were...."

But Its Continued Use Now Threatens our Survival

Turning to the downside, Freese briefly explains the problems with coal burning. Sulfur dioxide (SO_2) was the first hazard clearly identified, as causing the acidification of lakes and the killing of marine life. The particulates from coal fires that carry SO_2 were reduced substantially, but the killing impacts persist. Centre stage has been taken by carbon dioxide, however, as a major contributor to global warming. The only solution on the horizon for this problem, and the one preferred by the coal industry, is carbon sequestration. This amounts to pumping the gas into old mines or under oceans. It is a huge waste management problem, akin to wastes from nuclear fission.

Freese therefore prefers that we swear off coal entirely and embrace alternative technologies that exploit more direct sources of solar energy, including wind power. These other sources can be used to power the release of hydrogen from water, to be stored in tanks. Hydrogen fuel can then be used for motive power, in automobiles and airplanes. The technology for this is already sufficiently advanced that recent news showed test buses operating on hydrogen fuel cells in Beijing. Major investment is still required to make the technology cost-effective for a mass market. Coal industry people prefer to carry on with the game they know and with the comfortable, unregulated context they have created by successful lobbying with the current government in Washington. This could inhibit the possible good scenario until it is too late.

The question for readers and writers of this journal is where to place the blame for failure to take appropriate action? It is not difficult to understand the interest of the coal mining and coal burning industries. The more interesting question concerns the viewpoint of those who provide the financing, whether it is to continue funding the coal industries or to speculate seriously in alternatives. Where is the principal source of opposition to financing developers of solar collectors and hydrogen fuel cells, e.g.? To what extent can blame be assigned to the financial and banking industry? Does the influence exerted on legislators and presidents come only from the financial resources husbanded by the coal industry from its own operations? Is the malign influence of finance mainly an indirect one that stems from the existence and evolving nature of financial instruments and the ancillary, complementary practices of measuring and calculating values in numbers that represent money? Or is it none of the above? To what extent is it the "mythology of growth" and the doctrine that it is the laboring class that chiefly benefits from policies that encourage investment in "growth industries" via job opportunities? And that prompts a question of which social classes today gain the most from the kind of growth that has been experienced over recent decades. Has it been workers or speculators?

Keith Wilde

Our Blogging Department

William Krehm to Keith Wilde (01/07)

Dear Keith: I found your interchange with William B. Ryan on Douglas and Social Credit most interesting. I will barge in only to clarify COMER's attitude not only towards Douglas, but towards almost any social reformer of the past. We should listen to them carefully, but as citizens of their own age working on their own set of problems. What this might provide us with will certainly not be a carefully organized guide to those of our own, but alert us to the lessons from humanity's past successes and failures.. History and its lessons, however, have been systematically interred. Wasn't the "end of history" announced by one retired Washington bureaucrat when more and more of it, definitely of the wrong sort, began being turned out in record quantity?

The first striking thing about Douglas is that writing immediately after WW I – undoubtedly in part due to the influence of the Guild Socialists and his collaboration with O.R. Orage – was able to step outside of the magic circle of the great technological revolutions of his day. That was something that the great Karl Marx and Vladimir Lenin were unable to do. For who cannot see the influence of the great railway building age into which Marx was born in his view of social development with its stations laid out in orderly procession – primitive communism, feudalism, industrial capitalism, to the grand terminal of Socialism – barring the occasional derailment, i.e., counter-revolution. Lenin carried the process further to Communism, where "every cook became a statesman and hence professional statesmen were no longer needed." And from that alluring vision Russia got the terror of Stalin and the Moscow trials.

Instead of becoming dazzled witless by the wonders of new technology, Douglas sat under the Tree of Wisdom and asked: "Does man have to build a machine gun before he can buy a cabbage." At the time when Lenin coined the slogan: "Communism = Socialism plus Electrification."

And just about the time of the Russian revolution and Civil war, Douglas was developing the need for alternate life styles helped along by a social dividend to all members of society.

To "justify" such alternate life styles economically he developed the notion of a "social heritage" that emphasized the contribution to modern productivity of forgotten prophets, slaves, martyrs, inventors, scientists, plain drudges.

Such alternate life styles would help make possible for those who wished to drop out of the rat race to cultivate handicrafts, the arts, write poetry, do voluntary work protecting the environment and those in society who need special care. And without being branded as "petty bourgeois: even "lumpenproletarians"! Going through the "Satanic Mills" of heavy industry in the left Marxian view was essential to prepare the workers to become hardened fighters on the barricades of 1848. But the technology of killing decades ago made those barricades as outdated as the dodo.

We can find in Douglas as we can in Henry George many of the clues to get out of society's current nightmare. I might mention the brilliant generalization of Henry George currently achieved by J.W. Smith in seeking out and eliminating the permanent privatization for gain of scientific insights, i.e., the perception of something that was always there. Inventors and scientists are to be rewarded significantly for useful discoveries, but these should remain in the public domain. Otherwise – like the private ownership of land' the rent collected on their patenting or permanent privatization converts the collateral effects of the communities's development as a source of rent, which gets

compounded with all the other patented and monopoly incomes devised and appropriated by rent-seekers, to the point where the demands of this private rent compounding becomes a dominant factor in price rise, social inequality, and budgetary deficits.

Douglas, as a highly independent thinker, even devised his own nomenclature which has not made it easier to penetrate his message. Thus his A & B Theorem baffled me for years. I identified it with "accrual accountancy" that our governments were ignoring. But accrual accountancy deals with the depreciation of a capital good over its useful life – which can well be a half century in the case of a building. What concerned Douglas and brought him to devise his A and B Theorem was the period during which it was being *built*, rather than *used up*. He was wrestling with the need for liquidity while a capital good was being built – a period that could span several pay days, and the problem arose where the financing could be done before the proceeds from the sale of, say the equipment being produced, were completed. His own experience in supervising such a financing problem set his mind thinking on the subject, and he had a mind that worried a problem until it got to its roots.

Obviously the one he was dealing with raised the danger of exploitation by the financial sector, and the solution was not to write a mortgage, but for the workers and entrepreneurs to arrange from their wages some modest financing to protect them from exploitation by the financial sector. The answer was co-op banking based on the income of workers and small entrepreneurs. It was an advance warning about the nightmares of uncontrolled financial monopolies.

Multiply the discussions that you and countless others are conducting on the Internet, and protect resources against the rent-seekers. It could make a decisive contribution to society's salvation.

Bill Krehm

An Evaded Issue Keeps Bobbing Up

At the very time that the next stock market collapse was narrowly evaded by the new US Fed chief mumbling something from the other side of his mouth than he used a few days earlier, more serious warnings came with cutting clarity from two legislators.

The Wall Street Journal (29/06, "Lawmaker Urges US to Step up Hedge-Fund Probe" by Kara Scannell) reported: "Washington – The Chairman of the Senate Judiciary Committee, is pressing the Bush Administration to review and step up its investigation and enforcement of improper trading by hedge funds, including short-selling, in the wake of a recent federal appeals court ruling that left a regulatory void over the fast-growing industry.

"'It's very important there be adequate investigation by the Justice Department and actions by Congress, if we need any new laws,' said Sen. Arlen Spector (R. Pennsylvania) at a Judiciary Committee hearing on the relationship between hedge funds and independent research firms.

"Sen. Orrin Hatch (R. Utah) said new rules might not be needed now, but he cautioned that there is a need to make sure laws are 'effective and adequate to ensure that the substantial power of hedge funds is not abused,' Mr. Hatch said the Securities and Exchange Commission needed to 'get on the ball.'

"The SEC brought 29 cases against hedge funds last year, up from 10 in 2002.

"The hearing came in the wake of a federal appeals court decision throwing out a rule requiring most hedge funds-fund managers to register with the SEC, reopening the debate as to whether there should be federal oversight of the fast-growing industry.

"It also came amidst allegations by a former SEC enforcement attorney that the agency had neglected to pursue a case involving Pequot Capital Management, and Wall Street banker John Mack, because of political pressure."

Who can Hedge against Manipulation by the Hedge Funds?

"The size and trading practices of hedge funds have attracted the attention of Congress. There are more than 2,000 hedge fund advisers with more than $2.4 trillion in assets under management, according to the SEC. Short-selling, or a bet a stock will fall, isn't illegal, but some companies allege hedge funds improperly ally themselves with research firms to manipulate stocks.

"Sens. Spector and Hatch acknowledged short-selling isn't illegal, and said 'by and large' most hedge-fund managers are operating 'on the up and up.' Yet Sen. Hatch cautioned that hedge funds are 'the wild west' and they are 'incredibly powerful.'

"Sen. Hatch expressed skepticism that the Justice Department and SEC were doing enough to curb abusive trading by hedge funds. 'I get the impression that if somebody asked both agencies who is ultimately responsible for initiating these investigations, they might just point fingers at each other.'

"Connecticut Attorney General Richmond Blumenthal warned that, if an attempt to regulate hedge funds is abandoned at the federal level, 'then states will join forces...to proactively protect our consumers.' He said seeking treble damages of abusive trading would send the right message.

"Meanwhile, former SEC enforcement attorney Garry Aguirre testified in greater detail about allegations that the agency shut down his investigation into Pequot after superiors received a call from Morgan Stanley. The brokerage which was about to name Mr. Mack chief executive, asked whether he was under investigation.

"Following the call, Mr. Aguirre said there was an 'abrupt reversal' in support of his case. He said he sent two extensive emails and a spreadsheet to his superiors. He listed several possible tippers of inside information about Pequot, and put Mack at the top of the list. He didn't describe specific evidence he had to support his allegation, and declined to answer questions after the hearing. The SEC said Mr. Aguirre's allegations are 'categorically untrue' and declined to comment on whether there is an investigation."

From Mr. Aguirre's public declarations: "I believe that the nation's capital markets face a growing risk from unregulated pools of money – now called hedge funds – just as they did in the 1920s from unregulated pools of money – then called syndicates, trusts or pools."

But there is a still deeper issue: hepped-up growth of the financial sector of our economy has become the sole alternative to a catastrophic bust, even though it is already undermining both society and the environment. The deeper question that still awaits asking in legislative circles is: can such growth be achieved, and ever accelerated without a full set of gangster tools and methods?

William Krehm

The Ambiguity of Corporate "Legacy Costs"

In our last issue we did some thinking out aloud in an article entitled "The Plays of Proportion." Since then we must thank *The Wall Street Journal* for drawing to our attention changing proportions of crucial items can take place within an institution shielded from public knowledge, but fatally affecting the institution's survival (23/06, "As Workers' Pensions Wither, Those for Executives Flourish" by Ellen E. Schultz and Theo Francis). The operational factor is another example of "the play of proportion."

"To help explain its deep slump, General Motors Corp. often cites 'legacy costs,' including pensions for its giant US work force. In its latest annual report, GM wrote: 'Our extensive pension and [post-employment] obligations to retirees are a competitive disadvantage for us.' Early this year GM announced it was ending pensions for 42,000 workers.

"But there is a twist in the auto maker's pension situation: the pension plans for its rank and file US workers are overstuffed with cash, containing about $9 billion more than is needed to meet their obligations for years to come.

"Another of GM's programs, however, saddles the company with a liability of $1.4 billion. These pensions are for its executives.

"This is the pension squeeze companies aren't talking about: Even as many reduce, freeze or eliminate pensions for workers – complaining of the costs – their executives are building up ever bigger pensions, causing the companies' financial obligations for them to balloon.

"A Wall Street Journal analysis of corporate filings reveals that executive benefits are playing a large and hidden role in the declining health of American pensions. Among the findings:

• Boosted by surging pay and rich formulas, executive pension obligations exceed $1billion at some companies. Besides GM, they include General Electric Co. (a $3.5 billion liability); AT&T Inc. ($1.8 billion); Exxon-Mobil Corp. and International Business Machines Corp. (about $1.3 billion each) and Bank of America Corp. and Pfizer Inc. (about $1.1 billion apiece).

• Benefits for executives now account for a significant share of pension obligations in the US, an average of 8% at the companies above. Sometimes a company's obligation for a single executive approaches $100 million.

• These liabilities are largely hidden because corporation don't distinguish them from overall pension obligations in their federal financial filings. As a result, the savings that companies make by curtailing pensions for regular retirees – which have totaled billions of dollars in recent years – can mask a rising cost of benefits for executives.

• Executive pensions, even when they won't be paid till years from now, drag down earnings today. Non-executive pensions are less of a burden in relation to their size because they are funded with dedicated assets. One reason executive pensions have grown so large is that they are linked to ballooning overall executive compensations. Companies often design retirement payouts to replace a percentage of what a person earns while active.

"But for executives, the percentage of pay replaced is itself higher. Compensation committees often aim for a pension replacing 60% to 100% of a top executive's compensation. It's 20% to 35% for lower-level employees.

"Even as executives' pensions grow, many companies are curtailing those for the rank and file. In one move, hundreds of employees, including Boeing Co., Xerox Corp. and Electronic Systems Corp. have switched to pension formulas known as 'cash balance' plans. One effect is to slow the growth of older workers' pensions or halt it altogether.

"Other companies, including Verizon Communications Inc., Unisys Corp. and Sears Holdings Corp. are freezing their pension plans for some workers. A freeze leaves intact pensions already earned, but prevents any further growth. Some employers have added pensions for executives at about the same time as they limited those for others."

The Hidden Company Assets in Some Pensions

"The promise of any pension becomes a corporate obligation. Although the payments are in the future, the promise means the company has a liability now. And a number can be put on it.

"Companies that restrict regular pension plans often point to the 401(k). Noting that they've enhanced their match of contributions. Unlike pension plans, 401(k) don't create a corporate debt or liability, since employees provide most of the assets and firms are typically free to halt any contributions of their own.

"Companies are also generally free to alter, freeze or end regular employees' pension plans, unless a union contract is involved. But executive pensions are often protected from management interference by employment or other contracts.

"A result of these trends is that executive pensions make up a significant portion of total pension liabilities at many companies: 12% at Exxon Mobil and Pfizer; 9% at Metlife Inc. and Bank of America; 19% at Federated Department Stores Inc.: 58% at insurer Aflac Inc."

Deferred Pay Cheques

"Companies' retirement liabilities for their executives have also grown through another little-noticed trend: Over recent years, an increasing portion of executives' pay has been postponed, via pension and deferred compensation plans, rather than given in current paychecks. Deferred compensation plans let executives put off receiving large chunks of their salary and bonus until retirement. The plans have often let executives defer other pay as well, such as gains from exercising stock options. The deferred sums grow tax-free. Sometimes they increase at an above-market interest rate guaranteed by the company.

"Even if a company's liability for executive pensions totals hundreds of millions of dollars, its employees and shareholders may never know. Companies don't have to report this obligation separately, in federal financial filings. When they do mention executive pensions in filings, companies often use terms that only pension-industry insiders would recognize such as 'unfunded defined benefit pension plans.' These are executive pensions.

"Pension plans, whether for executives or for others, are obligations to pay. In other words they are debts. And like any debt, they have what amounts to a carrying cost. In the case of pensions for regular employees, the expense is partly offset by investment returns on money the company set aside in the pension plan when it 'funded' it.

"Executive plans are different. They're normally left unfunded. They have no assets set aside in them. That means there is no in-

vestment income to blunt the expense. The result: executive pensions create far more expense for an employer, dollar-for-dollar, than pensions for regular workers.

"Why don't companies just fund executive pensions? Chalk it up to taxes. Contributions that companies make to regular pension plans are tax-deductible and grow tax-free. Congress set that rule to encourage employers to provide pensions for the rank and file. But a company that contributes assets to an executive pension plan gets no tax break. In fact, there's a tax penalty. Money contributed to such a plan is considered current compensation to the executives, and they owe personal taxes for it.

"These accounting effects may sound technical but they matter, because companies that curtail ordinary workers' benefits often cite their pension 'costs' or 'expense' as the reason.

"In January, IBM said it will freeze the pensions of all US employees, more than a quarter million people. That move reduced its pension liabilities by $775 million. IBM cited pension costs, volatility, and unpredictability. It didn't mention that one quarter of its US pension expense last year resulted from pensions for several thousand of its highest-paid people."

An unanswered and perhaps unanswerable question is this: "To what extent does this highly disparate treatment of rank and file employees and the high executives merely reflect a built-in bias in our society – growing ideology-based discrepancy between the affluent and the masses, and to what extent is it merely more of the pig-at-the-trough phenomenon?

Whichever you may choose, it is doing nothing to the survival of a system that divides the lowly producers and the executives by an ever wider gap in the reward assigned to each.

W.K.

Pity the Sowers and Reapers in Super Growthland

The high courts of our southern neighbours seem to be getting ever more clogged up with cases of every more shameless skullduggery involving corporate chieftains and the corporations themselves. But let us not be too harsh in moral judgment on those who – even in return for a mere zillion in options assigned to them – run their corporations with a sustained growth.

That was by its very nature a sinful assignment as set forth in Chapter III of Genesis "Now the serpent [who should have been awarded a so-called Nobel Prize in Economics had such existed at the time] was more subtle than any beast of the field which the Lord God had made, And he said unto the woman, Yea, hath God said, Ye shall not eat of every tree of the Garden?.... For God doth know that in the day that you eat of the tree which is in the midst of the garden, your eyes shall be opened, and you shall be as the gods, knowing good and evil."

In modern legal parlance, "you shall understand the consequences of your actions, with necessarily lie in the future." And when you take oath and promise your shareholders that the price of your corporation's shares as fixed on our stock markets shall not only incorporate a knowledge of future growth that must be sustained, as must the growth of the rate of such growth, and all rates of growth, all of which are incorporated for the convenience of shareholders in the graphs of stock prices past and future. And when the graphs that started in a horizontal position reminding us of the lowly crawl of the insidious serpent that with the wile of any high-paid fund trader sold Eve the bill of goods to eat the fruit of the tree of knowledge that will equip us to foresee the future and thus better control the future of our corporations.

That is why that curve on the financial pages that began as a lowly serpent-like crawl in no time flat comes to stand vertical. Nay, mistake it not for a another Viagra ad of the sort that afflict our internet mail, but recognize in it a presentation of the tree of knowledge that a CEO of a large corporation must have. For running a modern growth economy has a more marked forward lean than that of poor Adam developed when the Lord God sent him forth from Eden to till the ground.

The Creed of Portable-alpha

All this was foretold in Chapter III of Genesis. And we have no doubt that some not underpaid defence attorney will soon attempt to convince the high courts of its theological implications. Given the strong revival of religious fundamentalism that has sent their armies to impose freedom in much of the world – that the predestination of the erring CEOs was foreordained – rather like the very stock prices of the corporations that incorporate future growth rates of the corporations' public shares, even though they have yet to earn their first dollar in profits.

And just in case the reader may believe that I am making this up, I will cite *The Wall Street Journal* on some latest developments in the near-stricken fields of the stock market (29/06, "'Portable Alpha' Investment Strategy: A Better Mousetrap or Overly Risky?" By Scott Patterson):

"The hottest investment strategy on Wall Street sounds more like something one would take on a trip to the moon than a place to stash retirement funds.

"It is called portable alpha, and endowments and pension funds are throwing billions at it. Dean Barr, managing director of Citigroup Inc., which plans to launch an extensive portable-alpha offering in August, says it is one of the fastest growing strategies used by pension funds in the world. 'We've developed a better mousetrap here,' he said. 'Surely the high-paid copywriters used for the campaign could have chosen some more inspiring metaphor than "mousetrap"!'" That's surely like mentioning rope in the house of the hanged.

"The idea behind portable alpha is simple, though how it works can be complicated. Instead of stashing money in a mutual fund to invest in the market, investors use a derivative that tracks an index such as the Standard & Poor's 500 stock index. These financial contracts give them cheap exposure to the broad market, freeing up extra cash to put into hedge funds and other investments, providing the 'alpha' part of the strategy.

"Alpha is Wall Street's lingo for a manager's ability to produce better returns than a benchmark, such as the S&P 500, while 'bet' stands for the benchmark. In portable alpha, the 'alpha' is 'ported' or added, onto the beta, potentially boosting returns. There are numerous permutations of the strategy. Most use a combination of stocks, derivatives and bonds. For now, average investors can't invest in portable alpha, which, like hedge funds, are largely restricted to wealthy investors and institutions."

Having cleared up this background, it should be clear that the serpent's address has changed from Eden Garden to Wall Street.

William Krehm

Where Has the Money Gone?

In this computer-age links are technologically available by tapping a computer key with a single finger. Why then is there so much mystery about why the federal government should be rolling in surpluses, while the municipalities are in ever growing financial trouble. And yet of all levels of administration it is the municipalities that are inescapably cornered in a raw mass of neglected human need.

Here is some evidence from *The Globe and Mail* (16/6), a sheet of unblemished conservative bias. In "A taxing tale: Feds keep on getting richer – Canadians keep getting squeezed," Heather Scoffield rattles some hard facts:

"The country's taxpayers dished out 8% more in personal income tax last year, filling government coffers to overflowing, Statistics Canada says. Government surpluses, including those in the Canada and Quebec Pension Plans totalled $26 billion in the 2005-6 fiscal year ended March 31.

"Individual taxpayers are largely footing the bill, even though incomes are rising ever so slowly. Revenue from personal income tax climbed to $167.6 billion in the latest fiscal year from $155.2 the previous year.

"The same cannot be said for wages and salaries. They've been growing by about 3% over the past year, after being almost stagnant for much of the past decade.

"'You've got more and more people working, and more and more people getting this 3- or 4-per cent increase in income,' said David Perry, senior research associate at the Canadian Tax Foundation.

"He cites research by Dale Orr at Global Insight (Canada) Inc, indicating that for every 10% expansion of the tax-base, overall personal income tax revenues rise 12%. People gradually shift into higher tax brackets.

"Where is the wealth going? It seems…to government…. The exception is the municipal level. Ottawa has had surpluses for nine years in a row, and some of them have been huge. Provinces have been up and down, but the provincial and territorial governments had a combined surplus of $6.6 billion in 2005-06, compared with $317 million a year earlier.

"Local governments, on the other hand, 'recorded a combined deficit of $2.9 billion in 2005-06, more than double the previous year's shortfall,' Statscan said.

"Transfers from provincial governments to municipalities have risen steadily, to $40.1 billion in 2005-6 from $ 22.1 billion in 1998-89.

"But costs for municipal governments have been rising. Provincial transfers accounted for only 3.7% of total local spending in 2005-6 down from 5.2% in the mid 1990s."

In the same issue of the *G&M,* a second article ("Federal power grab hurts cities" by Neil Reynolds) reports: "Ottawa – It was only a year ago – June 17, 2005. With the applause of subservient provincial satraps, Prime Minister Paul Martin in effect unilaterally amended the Constitution, declaring municipalities henceforth a federal responsibility.

Verbal Blessings not Found in Our Constitution Act

"Finance Minister Ralph Goodale had already promised billions of dollars for Mr. Martin's revolutionary 'New Deal' for cities and towns, villages and hamlets.... But it was in Richmond Hill, a needy community north of needy Toronto, that Mr. Martin first defined his money-for-mayors strategy as a federal *coup d'état.* 'The New Deal is a national project for our time. This agreement recognizes municipalities for what they are – mature and accountable governments.' This recognition is found nowhere in the *Constitution Act*, *1982*.

"Cities are in pathetic shape these days. They need more money. They need more autonomy. From their own sources of revenue, Canadian municipalities collect an amount of money equal to 4.4% of the GDP. They spend an amount equal to 6.95% of GDP – which leaves 2.55% of GDP as a deficit covered by provincial governments. Municipalities rely on provinces for 40% of their spending. The provinces, in turn, rely on the federal government for 20% of their spending.

"Ironically, with all the fanfare that accompanies federal spending announcements, the federal government has been sending less money to the provinces in recent years than it sent 20 years ago – relative to the national economy. In 1985, federal transfers to the provinces equalled 4.2% of GDP; by 2005, they equalled 3.3%. The provinces have less money to support the cities.

"Canadian cities used to manage 40% of the tax revenues in the country, running schools, hospitals and orphanages, operating welfare programs, building roads and parks. They now manage 10%."

But what should disturb us most is that the policies that led to the present plight of the municipalities are neither sought out nor challenged. Not the slightest curiosity has been shown to identify what else was going on in the broader Canadian arena at the time that the real troubles for our municipalities began. If there were, a sure finger would point to the source of their crippling difficulties.

The bases for comparison in *The Globe and Mail* articles quoted tend to be some 17 years ago. That brings us to 1989. That is a highly relevant clue to the ultimate sources of our municipalities' woes. The 1980s were a period when banks throughout the world were deregulated, and allowed to take over the other "financial pillars" – something that the Roosevelt's *Bank Act* of 1935 in the US that came to serve as an international model, had blocked. It was also a period when the pegged interest rates that banks could pay or charge had been removed. By the early 1990s higher interest rates had become the sole "blunt tool" in the fight against "inflation." The deregulation of the banks had moreover given them access to the pools of liquid capital that the other pillars of finance retained for their own business. Once the banks had achieved that, they used those pools of liquidity as money-base for the bank multiplier – the issuing of ever higher multiples of interest-bearing credit for every dollar of statutory reserves they had to put up in cash with the central bank. It also gave them entrance into areas in which they had little or no expertise.

A double-pronged rescue plan was rushed in for the banks. In 1988 the Bank for International Settlements, a sort of central bankers' club that does not welcome any elected official of government at its meetings, launched its *Risk-Based Capital Requirements*. These declared the debt of developed countries risk-free, thus requiring no additional capital for banks to hoard. The result: between December 1989 and the spring of 1996 the chartered banks' holdings of federal Canadian government debt quadrupled from $20,542,000 to $80,088,000 or by over $79 million dollars. The average interest on government debt held by the banks during those years averaged – conservatively – 9%. That meant that the Canadian banks netted at least some $7 billion a year, at practically no cost to them. However, this resulted in the mov-

ing of massive government debt from the Bank of Canada, where the interest paid on such debt – less overhead charges – returned to the government as dividends. For since 1938, the government of Canada has been its sole shareholder of the Bank of Canada.

But that was only the beginning. In 1991 Canada's *Bank Act* (another piece of legislation governing the chartered banks) was amended to phase out over two-years the statutory reserves the banks had been obliged to redeposit with the central bank. This was a modest proportion of the deposits they took in from the public. Several purposes had been served by this arrangement. It had provided an *alternative* to raising the benchmark interest rate. Raising or lowering the statutory reserve, changed the leverage of the credit that the banks could create on the cash base they held.

Distinguishing Legal Tender from Bank-created Near-money

By contrast, using the benchmark interest rate as the "sole blunt tool "to manage the economy hits everything that moves or stands still. Particularly the unemployed who clearly cannot be contributing to inflation. Adjusting the credit-creating leverage of the banks and depending less on interest rates was a far less disruptive tool. It also provided the federal government with a cost-free use of the reserves for capital investments within the restrictions in force. In 1985 the statutory reserves had amounted to $130,195,000.[1] Once again using an average of 9% as the average interest paid on federal debt, we reach a figure of some $11.7 billion.

Adding the two together, we reach a joint figure of gains for the banks of over $18 billion a year.

But that is still not the whole story. In fact, it omits the punch-line: the very essence of banking is its multiplier of near-money creation.[2] In the case of the government bonds acquired wholly on the cuff, it is only interest not the principal that is available to the banks. The principal on such bonds, having been borrowed, is still wholly owing and hence balances to zero on the banks' books.

However, with the abolition of statutory reserves, it was *the use of legal tender* entrusted to them that came back to the banks. And that can serve as money base supporting the creation of as much as 400 times near-money – interest-bearing loans – for banks to gamble with. This was the hidden secret of the bank bailout of 1988 to 1993. Amongst banks it created a giddiness of ambition that was matched only by their ignorance of the speculative deals into which they hurled themselves. It was not only foreseeable but foretold by COMER that they would lose the money that had been bestowed on them in such princely amounts.

This can serve as money – base for the creation of a multiple of interest-bearing "near-money" that amounted to 11 to 1 even in 1946 when the Rooseveltian restrictions on banking were still in force. With their replacement in the ensuing decades banks have been allowed to take over the other financial pillars, and restrictions on interest rates removed – the only ones that survive today are under criminal law that clicks in at 60% per annum. Our banks are up to their eyebrows in speculation, and loan-sharking. Predictably that could lead to great bank profits, or equally spectacular losses of bank capital and bank deposits.

Moreover, the deep, dark secrets the banks and governments shared, both of the bailout and the loss of much of its proceeds, has enhanced the political power of the banks immensely. There is too much in their common past requiring cover-up.

Elsewhere in this and previous issues we have explained the background and various aspects of the statutory reserves. Our purpose here is to quantify what the banks' repeated bailouts and further deregulation has cost the taxpayer and thus has contributed to the current plight of the municipalities.

From time to time COMER has published an index called the Indicator that tracks how the deregulation of our banks that allowed them to take over the other "financial pillars" and led to an explosion of the ratio between their assets and the cash they hold. From a ratio of 11 to 1 in 1946, this had exploded to over 400 to 1 at the end of the millennium. Much of this was due to the discontinuation of the statutory reserves that essentially had made up the denominator of this ratio. What coin and bills that the banks keep in their coffers are needed for their banking business. If you excluded that, the denominator of the ratio would fall to zero, and the value of the ratio would jump to infinity. So we accepted all their cash holdings as reserves instead of something that had to be kept for such things as loading their ATMs. But on top of that, the their ability to use their legal tender wholly for investment, and their ability to take over the other financial pillars at home and abroad afforded them a license to put that additional legal tender to work as bank capital as well. That provided endless possibilities of conquest. (See Table 1.)

There was also the detail that the banks are allowed to enter their acquisitions at their historic value, i.e., their purchase costs rather than at their current market price – unless they own more than 20% of a security issue. With that our Indicator started losing credibility in our own eyes for excessive understatement.

Here we are concerned with the ratio of credit creation by the banks corresponding to two ascertainable sources of increased money-base. One is the interest collected on their increased hoards of federal debt which they were able to acquire for nothing. But the value of the bonds themselves are still a liability as well as an asset – on balance they add up to zero in their contribution to their *capital*. Only the interest on them collected by the banks adds to their income and may be retained undistributed to add to their capital. The phasing out of the statutory reserves, in contrast, amounting to $130 million released to them for other use of some $130 million of deposits. That, though it does not add to their capital, can be used for further credit-creation to invest in further loans or in anything they might set their hearts on. We are therefore on solid ground if we assume that they lent out the near-money that they could create on that additional money base, or invest in whatever scheme suited their fancy. However, to understate the case further we will take the bank multiplier as that of 1946 11:1. Rounding out the figures the bailout of our banks from their capital losses in the 1980s have been of the same order as the legal tender released to them by the ending of the statutory reserves,

Table 1: Indicator

Leverage of Chartered Banks in Canada

Year	Total Assets ($ millions)	Legal Tender ($ millions)	Leverage
1939	3,396	269	12.60
1946	7,233	653	11.10
1971	40,286	2,489	16.20
1980	252,933	6,568	38.50
1990	588,895	8,767	102.10
1996	992,544	3,356	291.90
1997	1,336,085	3,728	358.00
1998 (06)	1,365,766	3,762	363.50
1998 (09)	1,456,965	3,600	404.70
1999 (01)	1,394,967	3,763	370.00
1999 (06)	1,392,984	3,893	358.00

Sources: *Bank of Canada Statistical Summary for Early Years* and *Bank of Canada Review*

i.e., $130 billion in Canadian dollars plus another $7 billion in foreign currencies for a total of $137 billion. At an average interest of 9%, would have added another $12 billion dollars to the income revenue of the bailout leading to a total increase in income revenue of about $17 billion annually for all the chartered banks.

The Shattering Magnitude of Bank Losses

However, if we apply the 1946 bank multiplier to the capital thus released we find that it would have released approximately well over a trillion dollars of elbowroom for additional money creation. Surely the designers of the bailout must have put pen to paper to note the enormity of the bailout magnitude. There is only one explanation how such grotesque lavishing of public resources could have occurred – *the people in charge had a good inkling of the shattering losses that had already been incurred* to warrant even the magnitude of the bailout. It was a case of the unofficial principle: "Banks too big to be allowed to fail, are not allowed to fail." Period.

Obviously this would have been vastly inflationary, so the Bank of Canada in its wisdom raised interest rates into the 20% range to "lick inflation."

There was then some internal "logic" to the size of the bailout, and the unlimited scope of the war against inflation that was announced in the same year 1991. In his annual report M. Alexandre Lamfalussy, Manager of the Bank for International Settlements, declared that the best of governors of central banks are too ready to settle for 1% or 2% inflation, when what is necessary is absolute zero. In their innocent minds, this could be achieved of course by high interest rates. And that ushered in a period of prime rates in the 20% plus range. However, what all the central bankers overlooked was a minuscule detail: *when you allow banks that have lost all or most of their capital to load up with central government debt, they risk going bust again.* For when interest rates soar the value of preexisting bonds with lower rates collapses.

It was my original purpose in writing this article, to establish an understated range of costs to the taxpayers of this country of the repeated bailouts with subsequent further deregulation of our banks. As the costs grew more monumental as did the further deregulations after bailout and the further losses the banks once more sustained, the figures seemed *too big not by units but by digits*. For a while I tried out on using 1946 banking multipliers to calculate the near-money produced on a given money base. But even so, the bounty bestowed on banks was still too large by a couple of digits, If you took the figures for the 1985 statutory reserves which were released as legal tender by the ending of the reserves, and applied the 400 multiplier of year 2000 to them, you came up with credit creation that would exceed not only the whole GDP of Canada, but that of the US! I rechecked my figures, and counted not only their units, but their digits, with care. And then a thought struck me. There has been no serious concern or checking on what near-money creation was being released. *By then huge if vague quantities had already been lost by the banks*, and the zeal to win them back and still come out ahead was strong – the desperate optimism of the gambler who had already been parted from his wad. His one concern is to find the means to stay in the game and better and emerge a hero. Moreover, there was neither time nor knowledge, nor concern about how such financial might assigned to near bankrupts would work out. When you spend your time and talent hiding the fundamental facts of economics from the public, you end up in ignorance yourself.

Should my readers get the impression that I have entered a world of fantasy in all this, I must remind them that this is an era where hedge funds with dizzily leveraged billions and operating with complex derivatives that at times few if anybody understands. What we have uncovered in this modest exercise is just the effects of all this swarming shadow economy on the real one.

It provides a key to many of the puzzles of our epoch. For example the sudden passion of the historically isolationist superpower, which up to the present has shown very little concern for freedom in other lands, should suddenly have embarked on high military adventures to bring in democracy on all continents. For military adventure is the ultimate means of resolving the economic tangles of a misdirected peace. There is an urgent need for a Royal Commission to enquire into the above matters.

William Krehm

1. My source for the statutory reserves is the Canada Year Book 1988 page 18-14 which gives the statutory reserves for the year 1985, It can only be assumed that by 1991, when the two-year phase-out was begun, the amount would have risen further.

2. Near-money is debt of banks or other institutions that bear interest, having been loaned into existence. That makes their value move inversely in relation to interest rates. That instability of its value is a defect for a monetary standard. Money created by the government (through its central bank) and *spent* into existence, hence earning no interest, is not subject to this defect for use as monetary standards and hence qualifies as legal tender.

Post Script

As though to reinforce the train of revelation in what began as an innocent calculation of what the Great Bailout of the 1990s had cost the nation, *The Globe and Mail* (21/06) updates this tale of sunken continents of losses when our government claimed to be bringing the nation into a new era of prosperity and enlightenment. That, however, made more of the same indispensable both for the cover-up and for the continuation of the same that it entailed. What was hidden in fact was an ongoing system rather than a few isolated facts.

"CIBC hit with insider-trading lawsuit" by Sinclair Stewart recounts: "The Canadian Imperial Bank of Commerce and dozens of its affiliates were hit yesterday with a $2 billion (US) lawsuit that accused them of participating in a 'multi-year scheme' to profit from the sale of shares in telecommunications company Global Crossing Ltd.

"The insider trading allegations could represent another black eye for CIBC, which is trying to turn the page on what has been a bruising few years.

"The country's fifth largest bank paid $2.4 billion last summer to settle a class-action suit by investors at Enron Corp., and before that paid $125 million to settle its alleged involvement in a US mutual-fund trading scandal.

"Yesterday's legal salvo, filed by a trustee representing Global Crossing creditors, claims that CIBC and several related companies engaged in insider trading of the fibre-optics company's shares. The suit contends that CIBC and others made $2 million in profit from this trading, even though they allegedly knew Global Crossing was in poor financial health. Many of these related companies were controlled by former CIBS executives.

"While the defendants were making a fortune from insider trading because of the company's 'statements were manipulated to appear robust, in truth many of Global's operations were struggling and the company was at all relevant times insolvent,' alleged the suit, filed in a New York bankruptcy court.

"A CIBC spokesman declined to comment on the matter.

"Global Crossing was an undisputed cash cow for CIBC, and heralded the bank's single most successful merchant banking victory. In late 1996, the bank paid $38 million for a 38% stake in the upstart fibre-optics carrier; less than 1.5 years later, when the company launched its initial public

offering, the bank's stake was worth nearly $1 billion.

"A group of junk-bond executives who worked for CIBC in the US, and who had previously worked with Global Crossing's founder, jump-started the bank's involvement. Five of these executives served on Global Crossing's board, but the last of them retired when CIBC sold $710 million worth of its stock. The suit claims the bank wanted to divest its position 'anonymously,' so it would not alert other investors that Global Crossing's main underwriter was dumping its stock.

"Global Crossing emerged from bankruptcy protection in 2003. The trustee says creditors still have more than $6 billion in outstanding claims."❧

The Unheeded Lessons from the Gulf States

Our blinkered economists who have been elaborately trained to see one major cause for all evil – "inflation." And one way of fixing it – higher interest rates, are setting up the world and themselves for some great surprises. Let us quote *The Wall Street Journal* (6/07/06, "Rig Shortage roils US oil and gas market" by Mike Spector):

"The biggest long-term threat to oil and natural gas production in the Gulf of Mexico isn't hurricanes, it is the dwindling supply of drilling equipment.

"Jack-up and deep-water rigs, the massive platforms and ships that drill for oil and gas in the ocean, are leaving the Gulf of Mexico for more lucrative jobs elsewhere. This is expected to accelerate the decline of production in the Gulf, putting upward pressure on energy prices. The rig exodus is squeezing what was already a tight market for drilling equipment. In 2001, about 148 rigs were in the Gulf. Now about 90 remain, and are expected to leave soon.

"The rig migration will have the most pronounced effect on natural gas production and prices, because most of the rigs leaving the Gulf are jack-ups used to find gas in shallower waters. Gulf gas reservoirs are often quickly exhausted, so energy companies must keep punching new wells to maintain production. The Energy Information Administration, a US government agency that tracks data on the industry, predicts natural gas will cost $10 (US) a million British thermal units by the end of 2007, up from Friday's close of $6.104. Gas cost $2.43 as recently as the end of 2001.

"Gas is largely a local market, so upward pressure on prices can't be offset by increasing imports from overseas, and the impact of the Gulf's shrinking rig fleet on oil pricing will be smaller, but not negligible. Hurricane-related disruptions of Gulf oil sent world-wide prices jumping roughly $10 a barrel in each of the past two years. Analysts expect declining Gulf production to be one of several factors keeping oil prices between $50 and $70 a barrel during the next three years or so. Oil closed at $73.83 a barrel in Nymex trading.

"Why has the rig count dropped so sharply? The duo of hurricanes Katrina and Rita in 2005 destroyed five rigs. But the bigger factor is that drilling companies are signing long-term deals to send rigs overseas.

"Houston's Global SantaFe Corp., for example, agreed late last month to send four jack-ups – rigs that stand on stilts and are used in shallow waters – to the Persian Gulf, where Aramco, the Saudi national oil company, will pay more than $160,000 a day to drill for oil and gas for four years. Ensco International Inc. will send a jack-up to Tunisia next year, where it will fetch day rates of more than $200,000 for as much as two years of work. Contracts for the larger deep-water rigs are fetching day rates exceeding $500,000.

"Fewer available rigs mean fewer new wells to stem the annual declining production in the Gulf of Mexico, a region that produces about a quarter of US oil and gas. Federal offshore oil production, predominantly in the Gulf, decreased 19 percent between 2003 and 2005, to 458 millions a year, according to EIA. Offshore natural gas production fell to four trillion cubic feet a year in 2004 from 5.1 trillion cubic feet a year in 2001. For years, the Gulf of Mexico – the birthplace of offshore drilling and a very active region for underway exploration dictated global contract terms for drilling equipment. But with the emergence of several offshore zones, the Gulf is being eclipsed by hotter prospects of the coasts of Africa, the Middle East and China. By contrast, many of the Gulf of Mexico's richest targets have already been drilled, leaving only expensive deep-water reservoirs untapped.

"The demand elsewhere has sparked a dramatic increase in offshore rig building. Companies world-wide are building 91 major offshore rigs, up from fewer than 10 in 2003, according to ODS-Petrodata, an offshore oil and gas market analysis firm. But this wave of new rigs isn't expected to start plying the seas until 2009. Tom Kellock, ODS-Petrodata's head of consulting and research in Houston, noted that several rigs missed their completion dates during the last rig-building boom in the late 1980s and earl 1990s. To build a jack-up rig costs $160 million to $190 million, and deep-water rigs can cost as much as $600 million.

"In February BPPLC agreed to pay $529,000 a day to keep a massive drill ship in the Gulf. The three-year contract starts at the end of 2007. BP leased the same ship in 2004 for $184,500 a day. The ship is nearly as long as three football fields and can drill in waters tat are 3,048 metres deep.

"'Just about any way you cut the cards, the Gulf of Mexico looks like it will be struggling in [rig] population and that is likely to force day rates even higher,' says John Olson, co-manager of Houston Energy Partners."

Politicians, including John Kerry, ex-presidential candidate, are very glib about regaining "fuel independence" for the US. However, for that it would have to scrap the one-blunt tool for "licking inflation" – high interest rates. The time to build drilling rigs for and sea drilling was during the period of depressed oil prices, but at that time rigs were being sold for scrap. It also takes capital to devise alternatives to oil which are clearly becoming not only harmful to the environment, but prohibitively dear. And to make that possible requires not only state backing, but the recognition of such essential investment to diminish our dependence on oil, and treat as such on the government books. It all points to an economic theory that rather than reflecting the short-term interests of an influential clique will concern itself with those of society. The economic misadventures in gas and oil Gulf States are a good sampling of the consequences of being confronted with a growing clutch of disastrous problems that are simply tagged as "externalities," while the one "blunt tool" is directed to flattening a price index that is a fraud.

W.K.

On Level Playing Fields and Other Bum Metaphors

What modestly calls itself the information age increasingly bends the language and transmits the resulting misinformation with lightning speed to lock minds against information.

We need only take the omnipresent cliché, the "level playing field," that has become the holy grail of big business. First of all, what we are immersed in is not a sporting affair implied in "playing field," but a grim battle for survival. Nor is there anything "level" about the encounter of transnational organizations and those who work or would like to find work in the Third World or even in the advanced countries. To level the field of such confrontations requires an active intervention of governments. Finally, in this deregulated world the match hardly takes place on *terra firma* but in a tossing, shark-infested sea. No mariner in his right mind would loose the cannon on deck or rip out the stanchions below.

Nor does the bizarreness of it all end there. Firms and governments have been engaged in twisting the facts so long that the head turns up where the feet should be. And then, having fallen victims to their own cunning, they rush in to make investments in parts of the world where governments have been playing their own games not unlike those that have now been put in place in the First World. Often they themselves end up clueless and marked victims as well as victimizers.

Take the news carried by *The Globe and Mail* (7/10, "Scotiabank to get piece of a bank in Japan"): The Scotiabank "is joining US investment group Ripplewood Holdings and a consortium of international financial institutions to buy the troubled Long-Term Credit Bank of Japan (LTCR). Scotia is hoping to pick up 10% of the Japanese bank."

To begin with a word about the Canadian banking, its past and the cost to the Canadian taxpayer of bailing some bank at least once a decade. Because Canada has only five really large banks, bank failures are relatively rare and almost invariably confined to small banks that do not qualify for the unwritten principle of North American banking: a bank too large to be allowed to fail is not allowed to fail. The bailout takes place in the form of changing the bank regulations, to replace the banks' lost capital. And since that would never stand up under the light of day, all this is done surreptitiously.

The facts and figures are hidden in a maze of gobbledygook slipped through parliament, with party whips ordering their caucuses to vote without debate or serious explanation of what is at stake. Often the banks are allowed to prescribe the nature of the bailout, which invariably over the past half-century have included further deregulation.

The Banks Turn their Backs on Dull Banking

This guarantees that the banks, made whole with a renewed sense not only of cash in their jeans, but of power over the government, return to the international gaming tables to have another go at winning big. This explains the monumental arrogance of the Four Biggies announcing their proposed mergers without even having informed then Finance Minister Paul Martin. It was the efforts of a few organizations like COMER to make public the sordid facts of the previous bank bailouts that blocked that – plus the raw deals that the public was getting to allow our banks to recoup their gambling losses in ever mounting fees and interest rate spreads.

By definition big game hunting is an adventure – if you knew in advance where the lion was lurking, half the macho heart-throb would be gone. The only things that Robert Campeau knew about the US department store business was what Mike Milken told him. Milken was the Leveraged Buyout guru of the day who arranged the financing of such deals until he ended in jail. Campeau himself was a Sudbury house-builder become office-building tycoon largely due to his excellent connections in the federal government. Days before Campeau sought protection against bankruptcy a false note appeared in the press stating he had arranged payment on the interest due on the convertible bonds of his firm.

The Reichmann brothers threw up fine office towers in Toronto, but were certainly not plugged into the power loop in Britain – when Maggie Thatcher sold them a bill of goods about transportation that would be forthcoming to make even the pretence of sense in their gigantic undertaking for the redevelopment of the derelict port area of Canary Wharf. Nothing contributes so much to the excitement of modern financial safaris as playing with other people's money. Successful developers with the help of their banks go on climbing until they reach their level of insolvency.

At the end of it all, the massive bailout funds came from two directions: the cash that the chartered banks had to put up at the Bank of Canada as a token backing for the deposits they took in from the public, was phased out. That meant that the ratio of bank lending to cash in the banks' coffers moved towards the sky.

And the Bank for International Settlements (a central bankers' club that allows a representative of a government at its sessions) issued its *Risk-Based Capital Requirements* that declared the debt of OECD countries which include South Korea and Mexico) to be risk-free, thus requiring no additional *capital* for banks to acquire.[1] And to provide more elbow-room for the bailout of the banks, the Bank of Canada reduced its holdings of government bonds from 20.8% of the funded debt of the federal government where it had been in the mid-1970s to 5.4% where it is today.

When our central bank holds federal debt the interest on it reverts to the government [substantially] as dividends, since its one shareholder since 1938 has been the federal government. When the chartered banks hold that debt the interest paid on it stays with them – even though the charter banks were able to acquire it since 1988 without putting up a cent of their own money. All in all these measures add up as a subsidy to our chartered banks of at least $5 billion a year.

Having been made whole again at the taxpayers' expense, our banks turned their backs on dull banking. They decided they were really bright fellows destined for greater things on the world arena. To hell with branch banking, financing grocery stores, or even medium-sized industries.

The Bank of Nova Scotia, the third-largest Canadian bank by assets is the most involved in foreign banking. The *G&M* (7/10) alludes to this less brilliant chapter of its efforts. So long as these efforts were confined to ex-British colonies in the Caribbean, it knew what it was doing. But when it advanced into bigger fields, in the words of this *G&M* article it "has had mixed success when it comes to investing abroad. In Mexico Scotia owns 10% of the Inverlat bank

and holds convertible debt representing another 45% of the bank. Since its original involvement with Inverlat that bank, like the Mexican banking system as a whole, has lapsed into deep trouble.

It was at this point that Scotia, having sent 20 or so vice-presidents to study the situation, increased its stake substantially, confident that it could outsmart the Mexican politicos on their own turf. But today, four years later, the Mexican banks are in trouble again. During the recurring banking crises of Mexico, Mexican politicians usually send their money out of rather than into Mexico. That they leave to Canadian bankers.

The same issue of the *G&M* reports Scotia has a 61% interest in Banco Sud Americano SA in Chile. It bought its original stake in this bank for $20.7 million, its first venture into Latin America. "Standard & Poor's Corporation this year downgraded Sud Americano's debt to non-investment grade." To meet that concern Scotia increased its stake in the bank from 28% to 61%.

And now Scotia "is expanding its presence in Japan," where it has had branches since 1961. It has some might company in the Ripplewood Syndicate: ABN AMRO Bank NV, Deutsche Bank, General Electric Capital Corp., Deutsche Bank, Mellon Bank, Paine Webber Group, RIT Capital Partners, and Travelers Insurance (Citicorp). But not a few of these powerful shakers have felt the agonies and delights of government bailouts, not just once, but repeatedly.

And the Japanese banking system – part of a different culture – has reduced using an undervalued currency as a means of promoting exports to a high art. Political influence, moreover, is the very woof of its financial system, with land prices and the stock market subordinated to its arcane interests. In such a setting the Bank of Nova Scotia is a kid in short pants. Even the mighty George Soros who made a cool billion and more in days shooting down the British pound and other currencies in 1992, took a bath trying to predict where the yen was bound. However, if our banks are that spunky, let them surrender their charters and gamble with their shareholders' funds, but not at our taxpayers' expense.

William Krehm

1. The distinction must be made between *legal tender* (i.e., cash) held by the banks and the *capital* requirements to which they are subject. All bank capital is raised initially as cash. But since cash does not breed interest, banks do not like holding more cash than is strictly necessary. Hence their cash gets invested in the ever more enticing ventures that ongoing deregulation allows; i.e., it may end up as *capital* invested in Indonesian bonds or Mexican banks.

Calls to Action

Summary: It is my view that at this juncture in Canada's history, it is imperative that all patriots join forces to muster a two-pronged defence of this nation – one via Parliament under the leadership of the NDP who are sitting there, and one via the courts under a team of the best constitutional minds of Canada. A lot of great legal work has already been done in this field. We would not be starting from scratch, nor would we flail around for too long. Time is of the essence!

From Richard Priestman to Paul Hellyer, Mel Hurtig, Connie Fogal, David Orchard, Jack Layton, Maude Barlow, Bill Krehm, Jim Stanford, Ed Finn, Peter Julian, Steven Staples, Tony Clarke, Peter Julian, June 24, 2006:

This letter is a follow-up to the letters of February 12 and 25, and May 14 re: "speaking with one voice" to inform and arouse Canadians about how we are losing our sovereignty, independence and our civil liberties. Many of you have written and spoken of your concerns about how we are losing Canada, but we have not had governments which reflect these concerns.

For example, on June 10/05, Peter Julian (Burnaby–New Westminster, NDP) rose in parliament to say, "the Canadian Council of Chief Executives wants to eliminate virtually everything dear to Canadians. Its plan for deep integration proposes to eliminate the Canada-US border, impose American regulations, increase the foreign takeover of our energy resources, and create a common North American identity."

Looking back at the work of Tony Clarke and the Pro-Canada/Canada Action Network, from 1989 to 1993, Mel Hurtig and the National Party, Paul Hellyer and his attempt to create "one big party," we see the same concerns that we see to-day except that many of the fears previously expressed have materialized.

A very small step towards bringing together the fractured "progressives" was taken on June 8 when the Kingston and the Islands NDP Riding Association adopted the following resolution:

"That the NDP, locally and nationally, initiate discussions with other socially progressive groups and individuals, to explore ways to implement progressive policies while there is still time to preserve Canada's national identity."

It is the intention of the Riding Association not only to forward its resolution to the NDP convention in September, but also to begin discussions locally with other socially progressive groups and individuals to explore ways to implement progressive policies. While these meetings will have an educational value, the focus will be on finding ways to implement progressive policies.

I believe there is increasing support for a coalition of progressive forces because there is so much frustration with the status quo, but who will pick up the phone and call one or two others and say, "let's get together and talk about this and see what we can do."
Richard Priestman, Kingston, Ontario

Dear Richard and all,

Paul Hellyer, as you must remember, tried very hard to facilitate this. We (CAP) at our convention in 2002(?) authorized Paul to seek unity on three issues: abrogate NAFTA, the use of Bank of Canada, and proportional representation. To Paul's advances, everyone said the One Big Party idea is great. Join us. But none of the other parties agreed to the unity of the three points. None of the parties approached has ever promoted the abrogation of NAFTA. The NDP consistently refuses to budge on that point. The last election, the NDP, as you know, removed the use of the Bank of Canada from its policy. We desperately need the NDP, because they are in Parliament, to take the lead, pick up the torch for Canada, and move to get us out of the corporatization mode.

Now, the total destruction of Canada is in high gear. All of the destruction is flowing from the NAFTA concept and model. The North American Union is NAFTA enhanced to perfect the demands of the corporate elite of North America. The NDP and others must call for the abrogation of NAFTA which would be the beginning effort to halt the North American Union and the preservation of Canada, sovereign and free.

The unconstitutional and liberty stripping anti-terrorist legislation is up for renewal now. My understanding is that not one NDPer voted against it the first time around. I would love to be corrected on that point. The NDP, being the only opposition party we have in Parliament, should be leading the charge to stop renewal. The 9/11

incident was used to justify liberty stripping laws and the laying out of the beginnings of a police state. There exists in the USA excellent investigative work and excellent alternative media work and professional exploration of the subject. In Canada, we appear to have little political exposure of this issue, yet Canada is now hooked into deep integration militarily, deeper integration economically, deep integration in foreign affairs, and in every other area that defines a country as sovereign, all justified by 9/11.

Right now, the Security and Prosperity agreement entered by the Liberals under Paul Martin, and further sanctioned by Harper is in full flower with at least 16 to 18 committees in Canada, and a similar number in the USA and Mexico, all hard at work implementing the North American Union expanding the NAFTA model. This is all being done bureaucratically. It is then deliberately, incrementally, put to Parliament, in piece meal, if at all, and by confusion and deception.

What we need now is a joint effort on this front. We need to do a number of things. CAP exists only because no one politically has been dealing with this whole issue of sovereignty, and the very survival of our Canada. We have just been through two elections in two years and this issue was never profiled by any of the mainstream parties who are the only ones with the capability to profile it properly.

The excessive power wielded by the Prime Minister's office and by the bureaucracy, all practicing the concept of the Prerogative Right of Kings, must be attacked and halted. The fact that Canada is in fast forward process of deliberate, meticulous, profound, fundamental restructuring, violating every tenet of our Constitution and our Charter of Rights and Liberties, speaks to the necessity of honest patriots to work together now, or we are guaranteed to be destroyed as a sovereign nation. Worse yet, being tied to the USA model which now has in place all the laws to implement a police state, means Canada is guaranteed to suffer the same horror.

Sovereignty over money is the core to

More than a Mere Difference in Arithmetic

More than a mere difference of arithmetic, there is a bottomless philosophical gulf that separates money coined out of gold and silver by our ancestral monarchs and the bank credit that has replaced it over the last half century. The credit of governments, these days delivered by our central bank is fiat money having nothing more to back it than the authority of the government. Fiscally, however that is everything, since everything within a given realm is subject to taxation, and if the resulting currency is restricted to needs of the economy within the given monetary technology, it is in no way inflationary. The government creates money – i.e., its debt – by *spending* it into existence. To earn interest whoever receives such currency for value delivered to the government must lend it out in a second transaction before it earns interest.

When commercial banks lend out their credit it is *lent* into existence. It bears interest the moment it is issued. Before it was lent out it existed only – when the banks had to leave a portion of the credit they created in loans with the central bank where – like the gold and silver that the ancestral monarch coined, it earned no interest by its mere existence.

Above all in the 1980s our banks got themselves into deep trouble, when they were deregulated allow them to engage in other financial business incompatible with banking – the so-called "other financial pillars." Some of these like insurance companies and mortgages engaged in activities that could tie up their capital for decades, whereas banks that deal in short-term accommodation must keep their resources highly liquid. Otherwise, should they engage in activities that are too conservative, or too speculative, they will not be able to honour the claims of their clients the deposits they have left with the bank, and the bank may suffer a run on it – depositors fearing for their deposits rushing them while they are still able to. And a run on one bank readily can become a run on the entire banking system, unless the government stands by as "lender of the last resource," and backs a deposit insurance scheme that will reassure the public.

The Banks Drowning in the Fatal Non-banking Pools of Liquidity

The first thing to note, is that in when the banks were deregulated and allowed to get into the non-banking pillars of finance – stock brokerages, insurance and mortgages, they used the pools of liquidity in which these institutions kept much of their capital to meet the needs of their own business. as money-base to make many times the amount in loans. For that is the legitimate business of banking, that makes it incompatible with these other "financial pillars." The "gimmick" underlying this both simple and tricky. When banks make a loan it rarely is carried around in the back pockets of the borrowers. Instead it is deposited in some bank until needed, and even when it is spent, once again the recipient likewise to deposit the proceeds in another bank. The end result is that the bank system ends up with many time the amount of additional deposits than the cash that the original bank held. When the banks lend out too great a multiple of the cash they hold and cannot meet the claims of their depositors, the government has – on repeated occasions had to step into make good the losses suffered by the banks in bad loans, bad gambles, and other misadventures that banks should not be allowed to expose themselves to. However, the essence of the deregulation of recent years has been to allow the banking system to create an ever greater amount of credit on their money base in just about any venture that might bring in a profit.

When they got themselves in major trouble, they were bailed out in two ways. First, The Bank for International Settlements – a sort of central bankers' club based in Basel, Switzerland declared the debt of governments of developed countries risk-free and hence requiring no additional capital for banks to hoard. The result in Canada – and very much what happened throughout the developed world – was that banks replaced much of the capital they had gambled away by loading up on government bonds acquired with nothing down. All they had to do was clip the coupons.

But the governments had to pay the piper for the tune – so long as they had borrowed substantially from their central bank, a substantial part of the net profits came back to them – as dividends if the government actually was the sole owner of the central bank as in the UK and Canada. But even in the US where a group of large private banks owned the central bank, most profits of the central bank still ended up with the government by right of *seigniorage* – the monopoly of the ancestral monarch in coining. *W.K.*

a sovereign nation. The North American Union will implement a separateness of the money field as did the European Union making it an offence for any body even to ask a question of the banking rulers on pain of severe penalty. My guess is that there is a money committee hard at work as one of the many functioning to deliver the North American Union.

I propose a number of things on which I suggest we should agree to work together.

1. The NDP, as a sitting party, should use all its authority to obtain full disclosure respecting the committees functioning to implement the NAU. They need to blow this wide open, giving the process full exposure and publicity to the general public. Probably 99% of Canadians do not even know it is happening. All the rest of us should use our contact bases to support the efforts of the NDP to wrest this information out of government.

2. The NDP, as a sitting party, should immediately call for the abrogation of NAFTA. All the rest of us should use our contact bases to support the efforts of the NDP.

3. The NDP should take the lead in the house and to the general public to prevent the renewal of the anti-terrorist legislation, and put on a valiant fight to restore full civil liberties in Canada. The rest of us should support the efforts of the NDP with our members.

4. The NDP should take the lead in the House calling for the renunciation of The Security and Prosperity Agreement and use all its Parliamentary resources to expose and broadcast to the general public this agreement, using whatever Parliamentary strategies and rules possible to cancel this agreement. The rest of us would marshal our resources to assist.

5. We should reach out to every small alternative party to join us, including the Green Party.

6. We should join forces to mount a constitutional lawsuit challenging the legitimacy of the Security and Prosperity Agreement, and asking for an interim injunction on the work of all the committees in process pending decision. We need to attack the unilateral, behind the scenes practice by the PMO and bureaucracy. There are only a very few lawyers highly skilled in this area, but they do exist.

7. The lawsuit should challenge the constitutionality of NAFTA. It has to in order to be consistent and thorough in overturning the process.

8. The lawsuit should challenge the Binational Planning Committee's work as unconstitutional which committee is working towards deep military integration which is well on its way.

9. The NDP should immediately call in Parliament for Canada's withdrawal from that committee and immediately call for the immediate assertion of Canadian sovereignty on international and military affairs.

It is my view that at this juncture in Canada's history, it is imperative that all patriots join forces to muster a two-pronged defence of this nation – one via Parliament under the leadership of the NDP who are sitting there, and one via the courts under a team of the best constitutional minds of Canada. A lot of great legal work has already been done in this field. We would not be starting from scratch, nor would we flail around for too long. Time is of the essence!

Connie Fogal
Leader, Canadian Action Party

Do Governments that Gamble Big and Lose Also Join their Special Foreign Legion?

As North American stock markets experienced a medium-sized tsunami, the new US Fed chief, Ben Bernanke offered words of reassurance. He "urged bankers to bear with growing pains associated with the new global bank capital standards, which he said would improve bank supervision."

Then he went on, according to the Reuters News Agency, to something rarely mentioned by government or the media: "The Basel II bank capital accord – an effort by international banking supervisors to update an earlier international bank capital accord (Basel I) which has been in effect since 1988." This he said "would more closely link capital requirements with risk, and keep regulators abreast of rapid changes in the financial services industry."

A few explanations to permit our readers to grasp what Bernanke is talking about, and what Bernanke is not talking about.

What is Basel I? Basel is the location of the Bank for International Settlements BIS), set up in 1929 to handle the syndicalization of the German Reparation Payments from WW I. German could pay them only in German marks, which France and Belgium did not want, and hence BIS was set up to create and market the bond issues in US dollars or some other strong currency.

The original shareholders of BIS were supposed to be central banks, but because of the isolationist stance of the US Federal Reserve, a syndicate of American commercial banks took up the quota reserved for the US. Today the shareholders and members of BIS are still these central banks, and what remains of the US bank syndicate. This is in contrast to the International Monetary Fund and the World Bank in which governments themselves are directly involved.

Several central banks, including those of France, Belgium, and Denmark, along with the US bank syndicate have sold substantial portions of their BIS share holding to the public. Yet only the original subscribers can vote, with voting rights allotted to the number of shares *originally* held.

BIS goes out of its way to thumb its nose at the most routine democratic principles. Prominent amongst these is letting the world know what it is up to.

Henry H. Schloss, author of *The Bank for International Settlements,* has written that the purposes and functions of the BIS remain "somewhat clouded and mysterious. To safeguard the bank's independence a director of BIS cannot be an official of a government or a member of a legislative body, unless he is a governor of a central bank. It is this provision that gives BIS its characteristic as a central bankers' organization, and it has jealously guarded itself against the intrusion of government officials."

The stock market crash of 1929 intervened, and the project and BIS were essentially put on the shelf. In that wall-flower role, was able to do some signal services to Adolf Hitler, in peace and war.

Schloss went on to say that in the 1940s, it was alleged that the BIS appeased and even collaborated with the Germans, before and during World War II. He writes that "the Bank may have been guilty of appeasement *in the late 1930s.* But the charges of pro-German conduct by the Bank *during the war* are essentially unfounded."

It is, however, a fact that when the Nazi army entered Prague in 1938 BIS almost tripped over itself to surrender to the Germans the gold that had been deposited with it by the Czechoslovak government.

Both charges haunted the BIS during the immediate post war, and at the Bretton Woods Economic Conference in 1944, Resolution 5 was adopted, calling for its dissolution at the earliest possible date.

A War Room for Reconquering Turf from Governments

That led to BIS cultivating a low profile. Some of its offices were in fact located over a pastry shop, and required some hunting down by to find. But by 1951, when the US private banks were regaining control of the US Federal Reserve which they had lost to reformers during the Depression, BIS was busy plotting the return of world central bank policy to the standards of the 1920s. Commitments made to their peoples by governments during the war for a more egalitarian world had led to the banks doing their planning for a proposed comeback not only *outside* but to an extent *against* their governments. The low profile cultivated by BIS commended it for the role as an underground "war room" from which to direct that campaign.

In 1988 it surpassed itself by organizing the bailout of banks throughout the world from their huge speculative losses. It sponsored the *Risk-Based Capital Requirements*, now referred to as Basel I. Its principal provision declared the debt of developed countries "risk-free," thus requiring no additional capital for banks to acquire.

The other measure was the phasing out – or otherwise making ineffective – the statutory reserves – a modest portion of the deposits made by the public with them that banks had to redeposit with the central bank where it earned the banks no interest. These reserves had provided the central banks with an alternative to raising interest rates to cool an overheated economy. With their discontinuance in Canada, New Zealand, and in any country obtaining financial aid from the International Monetary Fund – higher interest rates were left as the sole "blunt tool" to fight perceived inflation. In countries with governments less servile to BIS, the reserves in one way or another were reduced to insignificance but are still maintained.

The government of Brian Mulroney in Canada, actually tried putting the independence of the central bank from the government and "zero inflation" into the Constitution, but was voted down by his own caucus in the finance committee. In the UK it was reduced to 0.65% of one per cent. In the US the reserves are shifted automatically to "non-reservable," i.e., interest-earning accounts at the close of business each day and back against when banks' doors re-open. Under these new provisions, Government debt was shifted massively from the central bank where the interest paid on it returned substantially to the governments as either dividends (where the central bank is nationalized) or as *seigniorage* (conceptually the continuation of the ancestral monarch's monopoly in coining precious metals). Shifting government debt from the central banks to the chartered banks of course left a screaming hole in the government budget. That problem was addressed by downloading social programs to junior government levels without adequate financing to support them.

But for all its cunning, BIS had overlooked a crucial detail. In his 1991 annual report BIS manager Alexandre Lamfalussy took to task the most zealous central bank governors for bringing down interest rates only to 1% or 2% instead of absolute zero. But he overlooked that if interest rates go up enough, the preexisting bonds with lower coupons amassed by the banks would shed market value and bring the banks into insolvency again. That indeed happened in Mexico at the end of 1994 when the banks had to be nationalized again, and a new stock market group took over. Even the marketing of government debt came to be done by stock market auctions! If President Clinton had not stepped in at the last moment with a then record standby fund ($51 billion), the two incompatible policies of BIS it would have brought down the international monetary system.

Clinton's resourceful Secretary of the Treasury, Robert Rubin, came up with a better solution.

For the first time, accrual accountancy was smuggled into the US government's books.

Here we must again penetrate one of BIS's great silences. When a private firm buys a capital asset, or when an individual buys a house, they must in calculating their net worth, enter the outstanding debt incurred for the acquisition as a liability, and to balance it enter on the asset side the value of the building depreciated over its foreseeable useful life. That is known as "accrual accountancy" or "capital budgeting." This practically no central government in the world used before 1996. Until then practically all governments used "cash accountancy," treating the value of the acquired capital asset only as an expenditure in the year of its acquisition and thereafter entering its value at a token $1.

This disregard of double-entry bookkeeping had a grievous chain of consequence. It showed a growing deficit that was not necessarily there. That false deficit affected the bond rating agencies' grading of government bonds, and drove up the rate of interest governments paid.

This misrepresentation of the government balance sheet also provided a pretext for raising more taxes than strictly necessary. Then that extra layer of taxation in price was mistaken for "inflation," i.e., an excess of market demand over market supply – even when as in the case of consumer taxes it appears clearly for what it is on all invoices. That created a constant exaggeration of real inflation. That once again pushed up interest rates and led to bankruptcies and increased unemployment. And the breach of the most elementary rules of accountancy led to a massive shift of income into the hands of the financial sector. And with that came the political power to buttress this flawed accountancy.

Finally, to cope with the growing bogus deficit, government assets – highways, buildings, were privatized. Carried on the government books at $1, they could be sold at a small portion of their real value, and a profit booked to reduce the bogus national debt. Then while the taxpayer paid a second time in user fees for what they had already paid in taxes, they were revalued at their real value or better and listed on the stock market. It is the phoney accountancy in the public sector that laid the basis for the profitable Mergers and Acquisitions that our deregulated banks have become involved in, profiting by their inside knowledge of many corporations from their decontrolled banking activities.

The US introduction of accrual accountancy appeared first in the January, 1996 figures for "national savings" of the Bureau of Economic Analysis of the Department of Commerce. Carrying back the change to 1959, some $1.3 trillion in government investment was retrieved. But this result was presented under the heading of "savings," which it was not since the term implies cash or very short-term securities readily convertible into cash, and what was involved here were investments in the form of buildings, equipment. But this concealment of the real nature of the transformation was an essential part of the operation. The "political centre" that President Clinton was determined never to surrender, holds that governments are not capable of making investments. They are good only at wasting tax monies.

Only the banks, that governments bail out periodically, can invest prudently.

That militant belief turned up in somewhat other form in Canada where then Finance Minister Paul Martin resisted the efforts of then Auditor-General Denis Desautels to follow the American example. A long line of Auditors-General had already made the proposal plus a couple of Royal Commissions. To no effect. But now with lower interest rate having become a necessity because of the banks' bond hoards, Desautels refused to give unconditional approval of two years of federal accounts unless the step were taken. For weeks the battle raged with the A-G even accusing the government of "cooking the books." But finally, a compromise demeaning to the country and the Auditor-General was reached. A statement was issued emphasizing that the step was essential so that the real cost to the government of research projects of the space in government buildings required that the real value of that space be reckoned so that user fees could be set to cover it fully. More user fees for research projects rather than more essential public services became the keynote, with the A-G adding the humiliating statement that since the measure brought no new cash into the Treasury it could not justify further project spending. However, the change did prevent a great deal of "new cash" from leaving the national treasury for the private banks. However, the jump in the federal debt resulting from Basel I and the revision of the *Bank Act* in 1991 to end the statutory reserves, had shifted not only national wealth from the government to the financial sector, but political power. That downloading process of social programs without adequate funds to pay for them was then relayed from the provinces to the municipalities.

Basel I contributed greatly to the higher taxation and the slashing of vital programs. But now the period of high interest had been proved incompatible with the load of federal debt taken over by the distressed banks. Surely that meant that there would be less outflow of money from the federal treasury, and the savings could on a number of good grounds be used to make good the damage imposed on society, rather than frittered away by encouraging further speculative activity of our overextended financial sector. The latter, however, was the course taken.

With the introduction of accrual accountancy the tangle of false accounting and the resulting increasing concentration of political powers in the hands of the deregulated financial sector could have been fully disclosed and the compulsion to exponential growth stepped down in an orderly fashion. But that would imply the surrender of power to where it belongs in a democracy. And that has been denied society. The alternative is unsustainable exploitative growth of the financial sector at a cost to society, the environment and to world peace. For in the desperate situation into which exponential growth of the financial sector drives us, military adventure is the desperate ultimate gamble. The French Foreign Legion has offered adventurers who had gamed big and lost their place in society, a refuge and anonymity. In the name of democracy, military adventure offers our governments a similar final resort today.

Increasingly governments have been left with only the military card to play. No wonder that Canada's market sell-off should have coincided not only with the resumption of the interest-rate climb, but with Canada's denial of its commitment under the Kyoto Pact, and the two-year extension of our military adventure in Afghanistan. Canada in fact has joined Washington's Foreign Legion. *William Krehm*

Is the Main Threat to Washington's Might Coming from Within?

As the sun sets on a lone empire, particularly one that has used its military technology to alienate rather than seek the friendship of allies, the main threat to its preeminence is likely to come from within rather than from without. Imperial might, under such circumstances, comes to find its chief foe in the very viscera of empire, and greed of the upper caste seals its doom. While Washington's security concerns have concentrated on frontiers and illegal Mexican immigrants, its the law courts that have been clogged with top corporate cooking of the books. Yet the greatest damage was done by the official suppression of the brilliant work of American economists by the authorities themselves. No Bin Laden could have succeeded in so freezing the wits of the great American empire. The job was done by suppressing just about everything learned at a shattering cost during the Depression of the 1930s, and embodied in the Rooseveltian *Bank Act* of 1935. Every reminder of it has been expunged from the university textbooks. University staffs have been purged to that end. Publication is denied in the scholarly reviews in which publication can decide whether an academic thrives or perishes.

And lo who are today the beneficiaries of this self-immolation? The Chinese, who with all the obstacles of a tyrannic machine, are making the most of the US dependence on an exponentially expanding economy, of their own immense population, their millennial cultural background and discipline, and sheer native talent, to challenge the Americans at their own game.

The US Fed 17th straight quarterly application of its "one blunt tool" – higher interest rate for the 17th straight 1/4 percent increase of its benchmark plunged the stock markets of the world into panic. Meanwhile China is making intelligent use of the alternative to that one blunt tool – increasing statutory reserves, as provided by the Rooseveltian legislation. I quote from *The New York Times* (17/06, "Fearing Inflation, China Tightens Monetary Policy for 2nd Time in 6 weeks" by Keith Bradsher): "Hong Kong – China's central bank tightened monetary policy on Friday night for the second time in six weeks. Faced with the soaring growth in bank lending, the People's Bank of China announced that it would require most banks to hold 8% of their loan assets as reserves at the central bank, up from 7.5%. This means that banks will have a bit less money available to lend out for new houses, office buildings, factories and other projects, which could have the effect of slowing economic growth slightly. 'Although the consumer price index is still relatively low, if credit growth continues at a fast pace it is possible that the economy will heat up and there would be a risk of inflation,' the bank said in a statement.

"Experts on Chinese monetary policy said that the higher reserve requirement would by itself have little effect on Chinese banks. They pointed out that the new rules would require Chinese commercial banks to keep only an extra $19 billion with the central bank."

However, American experts, having lost familiarity with what has become an un-American practice missed the crucial point.

The $18 billion increase in the reserves the banks must put up with the central bank is in *legal tender*| not bank credit. And with the deregulation of our banks that lets them acquire stock brokerage, insurance and mortgage companies under the deregulated banking rules that the US has brought in throughout much of the world, that can serve to increase the banks' creation of near-money – i.e., interest-bearing bank credit as bank, i.e., interest-bearing near-money of as much as 400 times as its legal tender base. For it gives the banks access to more of the other "independent financial pillars" – the stock market, insurance, and mortgages and the money pools that they keep for their own businesses.

However, the American experts quoted were American experts who have been drilled to ignore this multi-storeyed effect on bank near-money-creation made possible by removing the firewalls between these pillars and banks.

The article continues: "By comparison, the banks are receiving almost all of the $18 billion to $20 billion in foreign currency flowing into China each month and are converting that foreign currency into Chinese currency.

"The new reserve requirement 'is very modest,' says Nicholas R. Lardy, a Chinese financial policy expert in the Institute for International Economics in Washington. 'This will be erased in one month.'"

But the use of statutory reserves – abolished in Canada and in developing countries receiving IMF loans, and mutilated to near meaningless in the US and the UK provides the Chinese government with a technique for the realisation of yet another monetary objective:

"China's central bank has been buying foreign currency from commercial banks as fast as foreign investment and China's trade surplus bring money into the country. The central bank has been paying for the foreign currency by printing more of China's currency, the yuan. The currency purchases are aimed at tempering a rise in the yuan's value against the dollar that would make Chinese goods less competitive in overseas markets."

The Two Non-blunt Tools Used by Beijing

The Chinese, then have used two non-blunt tools, to achieve two very distinct but in their eyes vital goals: (1) to moderate the inevitable price rise resulting from increased public investment in urbanization, and physical and human government investments; (2) to prevent their currency from soaring because of the influx of foreign currency due to their excess of exports, and thus choking off their exports. The recognition of the need for equating the number of independent policy tools with the number of independent objects pursued. Though Jan Tinbergen got his doctorate in physics, he needed only first year high-school algebra to develop his theorem. Nor was it stolen by the Chinese. They almost literally picked it up from the Western garbage cans where it had been dumped because the financial sector cherishes high interest rates as both its basic revenue and its gambling dice.[1] For some decades I know of no one these days apart from COMER that so much as mentions the work of Tinbergen, or the work of a host of other important economists on the same problem.

But continuing with the *Times*| article: "Bank regulators have already moved this spring to discourage loans for real estate ventures and factories in overheated industries like property loans and steel. The People's Bank also raised its benchmark interest rate on corporate loans by 27-hundredths of a percent on April 27, to 5.85%.

"The question is whether the interest rate increase in late April and now a reserve requirement increase will be enough to prevent higher inflation this year – or whether, as in the past, more drastic measures may be needed.

"When the Chinese economy threatened to overheat with rising inflation in 2003 and early 2004, China raised reserve requirements a full percentage point in August 2003 and by another half-point in April 2004."

Unlike the bone-headed Fed they hesitated to rely on "one blunt tool" and began tempering it with a second policy tool long ago discarded by the West.

That gives China – for all its problems another basic advantage: in addition to its population reserves that are of a higher mathematical order than that of the US or any European country and their millennial tradition of honouring scholarship and education. Of course, it does have its problems, of which corruption is only one. But what is the American purloining of economic theory in the interest of the sporting financial sector but corruption raised to higher systemic scale? We would recommend Washington address that serious threat to US security.

William Krehm

1. See Krehm, William (1975), *Price in a Mixed Economy. Our Record of Disaster*, Toronto, p. 39, and Krehm, William, editor (1999), *Meltdown, Money, Debt and the Wealth of Nations*, Toronto, COMER Publications, pp. 156, 184 and 185.

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