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CONTENTS

4 What Persistence in Afghanistan Calls to Mind
6 There Is Little that Ottawa Denies Our Most Miscreant Banks
7 Hats Off to The Globe and Mail
8 Emergency Measure Caught in the Storm Sans Compass or Shelter
9 Is Somebody On High Trying to Tell Us Something We've Been Missing?
10 In Search of New Resources — We Turn to Sociology
11 Protectionism
12 What a Hacked-up World Market is Trying to Tell Us
14 Refresh Your Memory of Your Country's History
15 A Posy of Splitting Headaches
16 Credit Dearth Changing the Very Topography of Stock Trading
17 The Survival Plan of The New York Times, Our Key Source For This
18 Clipping Off the Wings of America?
18 Children Parted from Parents in This United Walled World
19 Some Stinging Statistics

Our Call to Battle

The Wall Street Journal (26/02, "Obama's School Choice" editorial) minced no words on the matter of opening the best schooling to talented children, no matter how humble their parents' earning-powers. And wasn't the president a winged instance of that principle practiced?

But let us return to the editorial, remembering that the *WSJ's* basic purpose is hardly to champion the nation's underdogs no matter how talented: "President Obama made education a big part of his speech Tuesday night, complete with a stirring call for reform. So we'll be curious to see how he handles the dismaying attempt by Democrats in Congress to crush education choice for poor kids in the District of Columbia.

"The omnibus spending bill now before the House includes language designed to kill the Opportunity Scholarship Program offering poor students vouchers to opt out of rotten public schools."

Of course, it is an omnibus bill operating on the same principle that results in people without the necessary cash or private coaches traveling in public transport or in shoes in bad repair. The "law of averaging." However, talent does not average out, and when it happens it should be respected and treated as a national resource.

At risk of repeating ourselves – necessary because those who should be speaking up in our southern neighbor's legislature are no exception: they get the "issue" out of the way by disregarding it, or slitting its throat.

Inevitable because of the constraint of available time? Then they – as we, since there are no haloes around Canada's head in this as in other vital matters – seem to believe not that a knowledge of history would save us time. But rather that is "saved" by walking over the faces and hopes, of an elite of talent already sifted for quality by the first of life's tests. That is particularly inept because human investment has been identified as the best investment a government can make.

The lesson was purchased at the greatest cost ever paid for a lesson in both history and economics – it was one of the most important lessons to come out of World War II. Suppressing that lesson, and pretending that it does not exist, cannot serve a helpful end.

But part of due retribution is for those who have ignored crucial bits of our history be condemned to have it repeated to them through every available channel. Boring that may be, but we must at whatever cost let in a few rays of light in on such survival matters. COMER is putting on its battle jackets again and reorganizing to bring the survival message at stake in this matter to the public and government levels so that we can get ear of in both Canada and the United States. We are reorganizing both our publications and our membership towards this end. And here is the suppressed message that ignores a simple accountancy solution that got the United States out of a major crisis in 1996, and Canada to a lesser degree in 2002. And here are the details of the solution already tried and found workable in those years and now has only to be extended to human capital to get the country and the world out of a threatened melt-down without the government taking over a single bone-rotten bank, or the worst of its portfolio of lost gambles. Here is the suppressed bit of history that we must never stop retelling:

At the end of WWII Washington dispatched hundreds of economists to Japan and Germany to predict how long it would be for the two leading axis powers to regain their powers as key world traders. In 1961 –

Continued on page 2

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Battle *from page 1*

some 16 years later – one of these economists wrote a paper in which he stated it was amazing how wrong he and his colleagues had been. And the reason, he concluded, was they had concentrated on physical destruction. and overlooked that the highly gifted, educated, and disciplined work forces of those two leading Axis lands had come through the war essentially intact. His name was Theodore Schultz and for a few years he was feted and prized for having identified one of the great lessons of WWII: that investment in human capital is one of the most profitable investments a government can make.

Eventually this had great consequences of the way governments kept their books: private and corporate taxpayers were always required to enter every transaction in their ledger twice – once for the initial cost in cash or debt of the government and once for the current value of the physical assets of that investment. That was known as "accrual" or "capital" accountancy and that initial cost was "amortized" over the foreseeable useful life of the market value that was "depreciated" over at least approximately a similar period.

But that was not the way governments kept their own books. They did in fact *"amortize"* their cash cost over the foreseeable life of the asset value of the investment, but the asset value itself was *"depreciated"* in a single year, and at the end of that year assigned a value of a token dollar. This had two resounding results. It produce a capital debit on the government books that was not necessarily there, and it opened the possibility of lucrative privatizations for the well-connected. If you have bridges, raw land or buildings, and highways carried at one dollar, you can buy at "a thousand times book" and resell for a crazy profit and go to church with the gait of a philanthropist.

That convenient way of sparing many in the saddle of the risk of saddle-sores, was discontinued under much disarray at the beginning of 1996 in the US and very partially some six years later to a lesser extent in Canada. By the 1970s the banks had recovered from their devastating losses that they had gotten themselves in during the 1920s. By the time F.D. Roosevelt was inaugurated for his first term in 1933, 9,000 banks had closed their doors, and the first thing the new president did was to declare a bank moratorium during which all banks shut their doors. When they reopened for business the Glass-Steagall law had prohibited them from acquiring interests in "non-banking financial pillars." In those innocent days that covered only stock brokerages, insurance and mortgage corporations. The reason? The Great Depression of the 1920s had been brought on by the banks being allowed to take over non-banking financial companies and in that way getting control of the cash reserves needed for the acquired companies' own businesses. And once that happened that served the banks as "legal tender" base for their own banking multiplier. But many of these other pillars were already charging interest, the reserves from legal tender become "near-money," since in that case they move inversely with the rate of interest set by the central bank. So that not only left the acquired companies in potential trouble, but loaded the banks with a growing skyscraper of interest-bearing money of varied quality as the skyscraper of bank growth went up compelled to keep on rising in order not to collapse, with the element of risk supposedly "insured" against by derivative devices that would cause a first-year maths student to be kicked out of the course. It was like a crazy skyscraper that was compelled to rise ever faster with an elevator that could only go up, never down.

It Should Take More than "Insurance" to Evoke Trust

Its soundness was guaranteed by insurance companies on the basis of derivative "swaps." The details of such derivative constructs were banned from discussion at practically all international economics congresses in recent years that we have attended. But quite apart from the dubious assurance of the solidity derived from the exponential mathematical series that is the heart of the atomic bomb, John Maynard Keynes who died in 1946 pointed out years before his death the absurdity of trying to deduce from the experience of the past what will work in the ever-changing future on the basis of any mathematical or other assurance dubbed "insurance."

There had been a protection against the dominant power this would otherwise give banks whose basic revenue is interest rates. That had been the statutory reserves that required the banks deposit with the central bank a proportion of the deposits they receive from the public. By raising that proportion that lowered the net amount of deposits left to the banks to lend out themselves, this limited the effective power of the banks over the economy. But that was done away with systematically. Whenever the International Monetary Fund is called in by a country for help for its lack of foreign cur-

rency, the IMF lays down as a condition the end of the statutory reserves. The net result of such a position is to leave the benchmark interest rate set by the central banks in a monopolist position in managing the course of the economy. It raised interest rates to the position of "dominant revenue," so well described by the late great French economist François Perroux. It was the revenue of the group with monopolist power, by its rate of growth – both of its rate and absolute volume – that is taken as a reliable index of society's well-being as a whole.

Meanwhile, the "near-money" – interest-bearing short-term funds taken over by the banks as money-base for their bank-money creation, which every takeover of near-money involved as bank money-creation supposedly insured by derivative swaps – provided a bogus insurance based on an illiterate notion of what mathematics can do.

There is a howling need to bring professional mathematicians to teach economists and economics students the empirical content of any mathematical device is zero. Its analytical powers are what are unbounded. Contemporary economists that do not distinguish the two are at the basis of the current collapse of our monetary systems.

The ultimate bankruptcy of official economics today is that it has cast off all reference to the lessons of our own history and economic experience. Had this not been done and removed beyond all serious criticism, a completely *prepaid* package of capital resources would be recognized available to almost any of the developed countries in the world today.

By 1991 the adventures of the US banks in taking over the mortgage trusts (Savings & Loans) in the US had led to many of the banks losing most or more than most of their capital. The Bank for International Settlements – a world central bankers' war-room dedicated to bringing the world banking systems back to the freedom of the 1920s that ushered in the Great Depression – had declared the debt of developed countries risk-free and thus requiring no down-payment for banks to acquire. As a result Canadian banks increased their holdings of such debt by 400% to a total of $100 billion held entirely on the cuff, nothing down. At the same time the manager of BIS decided that there was to be no trifling with anything different from what they chose to call "zero inflation" to be achieved by pushing interest rates "high enough to do the job." The "job" was atrociously defined since nobody moving from a town of 20,000 population to New York expects the cost of living to remain the same. How then could it when humanity as a whole is making just such a move, quite apart from the technological revolution that makes anybody without a university education of the proper sort less and less employable? As a result, BIS's oversight almost brought down the world banking system. What saved it was the decision of the Clinton government that the days of high interest rates were over, to get around that one they finally listened to their auditing officials and decided that the time had come to bring in accrual accountancy and "depreciate" the physical assets of government not in a single year but in roughly over the same period as the cash or financed cost of a capital project was being "amortized." Doing this and extending the treatment to 1959 turned up almost $1.25 trillion of additional net worth *prepaid.*

That equipped governments to deal with physical investment except, of course, such government investments were financed in recent decades not with the Bank of Canada, where such costs would have been nominal, but through the private banking system. What still remains on our government books as current spending is human investments, that on the basis of Washington's costly researches, came up with Theodore Schultz's astounding conclusion supported in particular by Japan's imaginatively planned reconstruction of its economy from a textile-based one with most of its raw materials coming from abroad to a heavy-machinery-building economy where a vastly increased proportion of the gross income would remain in the country, Even during recessions the government would choose a single company in each of the new engineering lines to proceed with innovations that would at the next economic revival become available to the entire industry. You need brilliant, educated, talented managers to develop well in advance ideas like that.

The Suppression of Schultz and His Law

The detail pertinent to the present deepening current crisis of the world is with the suppression of Schultz's conclusion – for it was not simply "forgotten" – we still have a vast amount of government investment in *human* capital already invested and completely paid for that is on the government books not even at a token dollar. And yet, to treat *human* investment on government books for what it is after the job already done on the physical investments of government is a cookie-cutter affair. A cook used to reading recipes could handle the issue.

What would this be worth to the nation? Let us make the comparison of the US shift to accrual accountancy for its physical investments in 1996. The official calculation was at the time just under $1.25 trillion. Even the movement of the price level over a 13-year period for most of it, and another 37 years for a bit of it, would let us, say, double the figure for bringing in accrual accountancy to government investment in human capital today. But that calculation was based on continuing to use the private banks instead of the Federal Reserve for the financing of it. In Canada our central bank was nationalized primarily for such purposes. But it was no lapse of memory that prevented the use of the central banks in either country in shifting to accrual accountancy in their different degrees. This time that is part of the deal, since we are going to have to battle hard to get any of it through. That would bring the US figure for a similar job today up to at least $3 trillion and Canada to the usual $^{1}/_{10}$ of the American statistic or $300 billion.

But there are some unusual features of human investment. Its expenditure is in itself an investment. The children of better-educated parents for social as well as strictly genetic reasons tend to be better educated and healthier, and better adjusted. And their children, thanks to the same factors and opportunities, equally so. So instead of having spending, the result is more like further investment. Whatever England spent on teaching Isaac Newton algebra is still bringing in income to Britain in millions of ways today.

Obviously all levels of government will have to be included in this scheme for they contribute to the investments and hence are entitled to a participation in the returns. What sense then does President Obama's wasting both our time and bringing on a further debasement of the legal tender trying to straighten out the banking system en route?

On that point *The New York Times* (27/02, "Failing Upward At the Fed" by Floyd Norris) reports: "Sometimes nothing succeeds like failure.

"In his speech to Congress, the president asked the legislators to quickly reform financial regulation…. Representative Barney Frank, the chairman of the House Financial Services Committee, told me after the speech that he expected to pass a bill this year to make the Fed into a 'systemic regulator,' able to take jurisdiction over any financial institution if it threatens the financial system.

"Books will be written on the failure of the Fed in the last cycle. It decided that it did not have to worry itself over rising asset prices. So it stood by, first in the technology stock bubble, then in the house bubble. It saw credit getting excessively loose, and leverage piling up, but comforted us with the assurances that if there was a bubble, the Fed knew how to clean up after it burst, principally by cutting interest rates.

"It championed letting the shadow financial system grow without oversight, and shied away from doing anything about highly risky mortgages.

"Perhaps most important, the Fed and other regulators had no idea of how much risk they had allowed into the system. They knew that the various financial innovations were designed to let banks make more money without being required to put up more capital, but they did not figure out that meant that the capital there might be inadequate. They threw up their hands at the complexity of it all, and said banks could use their own models to assess risk.

"In sum, the Fed thought it had learned the lessons of the 1930s, but it had not learned the lesson of the 1920s, that allowing assets asset prices to soar to absurdly leveraged heights could lead to a collapse as the need to repay loans forced sales that drove prices lower, resulting in the need to repay more loans, and on and on.

"Even now, the banks being bailed out have not been required to detail the toxic securities they own. Without that information, it is impossible for even sophisticated analysts to assess whether each bank has taken all the write-downs it should. That is one reason banks are hesitant to trust each other."

And this is what the Obama regime has opted for rather than using $3 trillion of already invested capital that has financed the most productive investment a government can make cannot be just a slip in judgment, but a choice of loyalty. The prepaid human capital spent in retraining work forces, sending talented kids to college, cleaning up the environment will run up no debt but lead to a softening of the depression that is already upon us, and equip the professionals and workers for an early revival.

This is what the coming Obama crisis will be about. It will take more than charm and good intentions to get humanity out of the chapters of disaster that are blowing out of Washington.

That is why COMER is getting into campaign form once more.

William Krehm

What President Obama's Persistence in Afghanistan Calls to Mind

The New York Times (5/03, "Another Karzai Forges Afghan Business Empire" by James Risen) reports: "Kabul, Afghanistan – Eight years ago Mahmoud Karzai was running a handful of modest restaurants in San Francisco, Boston and Baltimore. Today, Mr. Karzai, an immigrant waiter-turned-restaurant – owner, is one of Afghanistan's most prosperous businessmen.

"The older brother of Hamid Karzai, the Afghan president, Mahmoud Karzai has major interests in the country's only cement factory, its dominant bank, its most ambitious real estate development, its only Toyota distributorship and four coal mines.

"He and a business partner run Afghanistan's national Chamber of Commerce – which has far more clout than its American counterpart – allowing him to broker deals and lure foreign investors. For executives with problems with the Afghan government, he is the man to see. One prominent Afghan critic describes him as a 'minister-maker' with sway in hiring and firing top officials.

"An unabashed advocate for money-making in the country his brother runs, Mr. Karzai attributes his success to having big ambitions and taking on ventures others saw as too risky. 'I'm interested in projects that require real work,' he said in an interview. 'I'm in love with the idea that Afghanistan can become a Singapore, a Hong Kong.'

"Mr. Karzai, though, has clearly exploited his connections, both in Washington and Kabul, to build his business empire. He has collected millions in American government loans for real estate developments in Kandahar and Kabul, capitalized on a friendship with Jack Kemp, the former Republican congressman, for introductions to American officials and international business executives. and benefited from what his rivals charge were sweetheart deals with the Afghan government.

"Mr. Karzai's swift rise has stirred resentment and suspicion among many Afghans, who have grown disaffected with the Karzai government and its seeming tolerance for insider dealing, bribe-taking, and other unsavory activities. Rampant corruption, experts warn, fuels the Taliban insurgency and threatens American support for President Karzai, who is seeking re-election this year.

"'If his brother wasn't president, would he have generated this much wealth, and gotten into this many deals?' asked Daoud Sultanzoy, a member of Parliament who has pushed for investigations into the Karzai family's business activities.

"Humayun Hamidzada, President Karzai's spokesman, denied that the president had shown favoritism to his brother.

"Mahmoud Karzai similarly dismissed complaints that he had traded on family ties. 'There is a great amount of jealousy and misinformation about me,' he said in an interview.

"President Karzai has privately complained that Mahmoud Karzai's business dealing are politically embarrassing, people who know him say, but he has not tried to rein in Mahmoud or his other siblings.

"One brother, Qayum Karzai, who owns an Afghan restaurant in Baltimore, served until recently in the Afghan Parliament, though other members groused that he almost never showed up. He said in an interview that he is now an informal intermediary among President Karzai, Saudi Arabia and the Taliban.

"Another brother, Ahmed Wali Karzai, the head of the Kandahar provincial council, has been accused of narcotics trafficking by Afghan and American officials, who are frustrated that the president has not taken action against him.

"Mahmoud Karzai, an American citizen, kept his Maryland home, but travels back and forth to Kabul from a multi-million-dollar retreat in Dubai owned by his business partner. Back in his homeland, Mr. Karzai, 54, talks easily in Pashto to Kandahari businessmen in native dress, and in fluent English to Westerners in suits. Politicians and business figures trade rumors and gossip about him. He says he is always looking for opportunities, while rivals fume that he has crowded them out or tries to get in on their deals.

"'People in the business would come to me and complain that Mahmoud always wants a percentage of the new businesses,' recalled Zalmay Khalilzad, a former US ambassador to Afghanistan.

"To his critics, Mr. Karzai offers an unusual defense: Even if he wanted to, he could not use an insider's advantage because his brother is ineffectual.

"'He will never make a decision,' Mr. Karzai said of the president. He is not a problem solver.'"

All of which recalls striking analogies that President Obama wouldn't and shouldn't like and should be avoiding. The role that oil plays in the Arabian peninsula was filled in the Caribbean by the prospects of, before it was built, and the security of the Panama Canal after it was completed. In any event, the United States, though terming itself "the land of the free" found itself imposing every conceivable form of subjugation on most Caribbean lands – with a single absolute exception – disallowing their democratic independence. Though this compromised its own legends and traditions, the American public handled that with minimal concern. At times – as in the case of the Dominican Republic the same small republic would undergo in rapid succession – a customs receivership administered by the US forces, complete occupation with the US army and/or navy taking over every government function. In the Dominican Republic where the American armed forces took over in changing roles – in rapid sequence in the customs collections, then occupied the entire Republic – as had already happened in Haiti with which the Dominican Republic share the same large island. In that way it was under the US flag that bloodiest dictatorship of the many previously experienced. That dictatorship of Rafael Trujillo lasted 31 years. Trujillo had been trained originally as a member of the US armed forces in the Dominican Republic itself. After leading the victorious war for democracy against Nazi Germany and Fascist Italy. The US government ran a special school in its Panama Canal Zone to train military personnel from throughout Latin America in methods of torture. Rafael Trujillo who was the dictator in Latin America most passionately supported by Washington, was amongst the cruelest, ever experienced in Latin America. When he was assassinated in 1961, a democrat was shortly after elected, but was overthrown within a few months. This was because of his support by a democratically elected government in Venezuela headed by Romulo Betancourt, that without hostility to the US, merely, still advocated and put into effect a redistribution of oil revenues between the foreign oil companies working in Venezuela and the host country – an arrangement that came to be adopted throughout the world.

And if Americans, including President Obama, are puzzled at the extent of the distrust, not to say hatred, towards the United States throughout much of Latin America the reason is to be found in this background – unfortunately still much to the fore – in US-Latin American relations.

Reenacting this deeply flawed script once again in Afghanistan is hardly going to remedy that situation.

The suppression of our own history, and even the of the fragments of lessons we may have learned from it, leaves us the most sincere democratic reformer, helpless to improve our relationship with the rest of the world. The fact that this is an age when military technology with a growing emphasis on space warfare does not leave the privilege of improvisation and sleep-walking. in crucial matters. To identify what can be resolved by compromise and negotiation, and what cannot, we must have a clean grip on what is discretional and what can become suicidal. But there is no way in which we can deceive other governments if we ourselves have curtailed our curiosity about the economic theory that we consider gospel and the extent to which it merely reflects the interests of speculative finance.

Everything that was worth owning tended to turn up as the dictator's possession. ; When he was eventually assassinated and eventually an elected democratic government elected, it was with American influences it was overthrown through US-backed counter-revolution as too left for its liking. Trujillo had been its ideal. This, was at a time when WWII was still on for saving the world for democracy.

That leaves us more helplessly dependent on military solutions, at a time when we have not retained enough grasp of peaceful solutions to the point of being able to shop without concern for our own breakfasts.

Rather than taking over key economic advisers of the Bush government, President Obama would be better advised to have a publicly organized review of all that was learned to work at huge cost, that has simply been eliminated from the record.

Anything less than that will leave such a mountain of betrayed hopes that will open doors to military solutions.

To disappointed problem-fatigued eyes, it may l seem a solution – keeping the rest of the Bush advisers on board. It could be the suicide of our culture if not of our very species.

William Krehm

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Even in the Depth of the Deepest Crisis There Is Little that Ottawa Denies Our Most Miscreant Banks

If you had to dream up a scenario of this sort, even the most gifted writers of fiction would be accused of abusing their readers' credibility.

Nor can it be a mere matter of the bad teaching of history in our schools. The crisis of the thirties which brought us a world war had also brought us the use proper use of central banks as a means avoiding the recurrence of major, world-wide depressions. It left us a precious record of how to avoid its recurrence. The central idea there as developed under F.D. Roosevelt when the world economy had collapsed around his ears immediately on his first inauguration as president.

Did it have to do with banks?

Most definitely it did. 9,000 US banks had already closed their doors by the time President Roosevelt entered the White House. And the first thing that the new president did was declare a bank moratorium during which all banks were compelled to shut their doors before their insolvency made it inevitable. And during that month, just about everybody with a view on this subject had access to the White House, whether the president could grasp what they were talking about or not. But he did try. And the evidence pointed so convincingly at the banks as the culprits who played the guiding role in bringing on the Depression – and with it the Second World War – that the most resounding legislation brought in by Roosevelt was directed at confining the banks to commercial banking. It set up or expanded the powers of the central banks to provide the government not only with the ultimate control over the pulse of the economy, but with a way of controlling monetary as well as fiscal policy.

A High School Dropout Who Beat Keynes to Unravelling the Mysteries of Money

As Canadians we should feel concerned about this heritage, because the keenest pioneer in the field was a high-school drop out who was working in a factory, but from that vantage point figuring out what had brought on the Depression and how to get out of it. Later he was to become Mayor of Vancouver, member of the House Commons and in that capacity the bumble-bee on Liberal Party leader Mackenzie King's bottom, granting him no peace until he had nationalized the Bank of Canada by buying out the 12,000 private shareholders, just three years after the bank was founded. This permitted Canada to finance its Second World War more efficiently than any of the other participants.

And that also swept the country into a productive quarter of century during which banks were strictly limited to private banking, and were disallowed to take over the non-banking financial pillars – at the time, stock brokering, insurance, and mortgage lending, to say nothing of many others developed by the banks since then – credit cards, marginal derivatives.

For this to happen, not only had the central government to acquire effective control of the finances of what had to be a growing public sector, but it had to keep the private banks strictly confined to simple banking. Surrendering to the banks, on even a single one of these areas, could only lead to an explosive power-grab by them. The use of the resulting financial non-banking powers to multiply the political power would essentially be suppressing our financial history.

The deregulation of the banking powers that enabled them to take over the other non-banking pillars was no one-way stop. When banks took over any business it becomes instantaneously added to their capital base, and the only rule for morality in deregulated banking is the rate of return that the bank can show on its total investment. That in itself exercises a dubious tug on bank morality in a variety of different directions.

A good example of the end result could be found in *The Globe and Mail* (14/01, "BMO gets its 'big ticket' insurer" by Tara Perkins). From the article you might never guess that the world as a whole, but in many respects particularly the US is in the midst of a pervading banking crisis that through the sub-prime mortgage and other collateralized debt.

This was brought on to a considerable extent by the banks having been allowed first to increasingly ignore and finally to achieve the repeal of the *Glass-Steagall* legislation brought in by Roosevelt at the end of the one-month banking moratorium – these had forbidden the banks to acquire interests in stock markets, insurance and mortgage companies. That contributed to banks taking the initiative not only in financing, but in dreaming up ever more daring schemes of keeping off the banks' books and the books of key clients the details of commitments that could not stand the light of day. And the one Canadian bank involved in the shakiest off-book plays of the Enron scandal that lost little time in collapsing was the Bank of Montreal (BMO). It actually settled out of court for something like $1.5 billion US. This in turn prevented the BMO holding back earnings month and after month, because it claimed that it required the release by a committee that apparently had a hard time meeting. I have personal knowledge of that episode, because a close friend paid Ottawa $10,000 in penalties, because it was unable to shake loose $10,000 of his savings, because BMO's committee could not meet to have the funds released.

And now we are informed that "Bank of Montreal has finally found a springboard for its life insurance business, thanks to American International Group Inc.'s near-death experience.

"BMO, the country's fourth-largest bank, is paying $375 million in cash for AIG Life Insurance Company of Canada, a move that will give it second-largest life insurance business of the big banks.

"'We've been looking at the insurance business for a long time,' said Gilles Ouelette, chief executive officer of BMO's private client group. 'In the past, it's been a really big ticket to get into this business.'"

Zero Morality Test for New Insurers

"This is the first sale of a life insurance unit that AIG has completed. The insurance behemoth is parceling off pieces of itself to repay the US government loans that saved it from the brink of bankruptcy."

With President Obama casting around for a solution – not too energetically to date – here he is allowing the banks – particularly

the BMO with its out-of-court settlement for having designed one of the off-book Enron scams.

"'We've been selling, but we've been selling other people's products,' said Mr. Ouelette.

Federal laws prevent banks in Canada from selling most types of insurance in their branches. AIG currently sells through independent brokers and direct to consumers, and BMO's roughly 800 investment advisers to sell insurance will now be another distribution channel.

"Despite the *Bank Act's* prohibitions, the big banks are increasingly pushing the envelope and forging deeper into the insurance business. Royal Bank of Canada has made the most progress, and has been establishing insurance offices right next door to many of its bank branches. Bank of Nova Scotia plants to test that model this year."

The "push" then is more of what brought the banks and the world into ever deeper trouble, rather than what eventually got it out the previous world depression.

"AIG Life of Canada, based in Toronto, has 300 employees and 400,000 customers, and has been ranked roughly 10th among life insurance companies in Canada.

W.K.

Our Hats Off to The Globe and Mail for Its Reportage on the Enduring National Shame of Vancouver's Downtown

More than cause for local shame it is a reason for a sense of national responsibility well beyond even over mountain ranges and even the Atlantic ocean. For the disinherited even of Ireland thrown by the English off their lush lands on the eastern part of their island to the rock-covered Western coast, opted in greater numbers for the "floating coffins" that would take them to Eastern Canada where some, fate lending a hand, might find their way to brighter futures. But inevitably a good many did not. These encountered, some of the ill-treated native Indians in what can only be seen as a human scrap-yard. for gravely tried human debris Vancouver's Downtown Eastside in more dimensions than not only economists, but even sociologists are used to handling. For local failure and responsibility would be a tremendously wrong miscue. Clearly it raises gaps even in the heroic efforts of sociologists to remind us bravely as they have laboured to find the dimensions of social disarrays, they have overlooked at least a couple of these that we have critical need of to restore world society to what might qualify as a functioning system.

To neglected areas of such life-preserving areas for world society are at once brought to mind by the sad plight of Vancouver Downtown Eastside strike us – social accountancy – that denies the status of capital to human capital – which had been recognized from extensive research sponsored by the US government after WWII when it sent hundreds of economists to Japan and Germany to study the damage and from it predict how long it would be before the two defeated powers could become outstanding competitors on the markets of the world again. The conclusion – one of the most significant lessons learned in WWII – came after 16 years of the peace, when one of these economists, Theodore Schultz of the University of Chicago published his conclusion: the American economists had been so wide of the mark, because they concentrated on the physical destruction, but had overlooked that the destruction had been mostly of physical infrastructures, while the investment of the government and country in human capital had come through the war virtually intact. From this Schultz concluded in 1961 that investment in human capital was the most productive a government can make. After being honored with medals and other recognition, after a very few years Schultz and his achievement were entirely forgotten and wiped out of official memory and authorized text.

This affects society today at the very time that we have crucial need of it. For what is worse than recognizing so crucial a relationship is suppressing the recognition that had been finally – if belatedly – accorded to it.

For one thing it impugns the very accountancy we use without which our economics can only be wasteful sport.

Nor are the further circumstances of the handling of human investment on our government's more assuring.

During the 1980s the neglect of the *Glass-Steagall* legislation brought in under Roosevelt in 1933 prevented American banks from acquiring interests in the other non-banking investment pillars – at the time, stock-brokerages, insurance, and mortgage companies. For that access had allowed banks to take over the cash and near-cash reserves that these firms needed for their own businesses and use them as the basis for their own credit-creation. What had resulted before 1929 and happened again when *Glass-Steagall* was less and less remembered until its final repeal in the late 1990s, was that the banks ended up not only a many-storied skyscraper of banking enterprise with elevators travelling only upward, never downward, at increasing speed. when this threatened to blow up in 1988, the Bank of International Settlements – a sort of war chamber of central bankers dedicated to bringing banking back to its pre-1929 glories declared the bank debt of the developed countries risk-free, and hence requiring no down-payment. Of course, the banks loaded up with it, and managed to continue expanding a little longer. But in 1992 the same BIS decided that "inflation" had become a threat and that interest rates would have to go up to flatten out the price level to "zero inflation."

The flaw there was a double one. First of all though it is true when there is more demand than available supply, prices will move upward – barring other factors. But propositions in logic cannot be turned around and still remain valid. If I hold a loaded pistol to my head and pull the trigger I fall dead. But from that you cannot deduce that because I fell dead I shot myself. It might have been a heart attack or any of many other factors. Moreover, no one moving from a town of 10,000 is fool enough to expect his living costs to stay the same. How then can he expect it to when much of humanity is making just such a move. Almost a half-century ago I had a long article published in what was the foremost economics journal in France – *La Revue Économique* – distinguishing between what I called the "social lien" – the layer of taxation in price that goes to pay for unmarketed public services.

Two distinguished French economists – independently – had been seeking just such an identified factor to account for their sta-

tistical analyses had independently shown a discrepancy between the excess demand of two groups of markets price increases. *La Revue Économique* has since disappeared, and any increase in the price level is taken as a sign of "inflation" – an excess of demand over supply, to be remedied by higher interest rates.

François Perroux, devised what one might call the sociology of a privileged revenue by which the welfare of society as a whole is identified with the increase in rate and volume of a privileged revenue Successively in post-Napoleonic England that has been the large land-owners who profited from the high food tariffs. Then came the industrialists when tariffs were reduced, then it became interest rates. Finally with the heyday of derivative swaps – quite literally the growth mathematics of the atomic bomb applied to financial income which led us into the world's current mess.

All bears witness for the urgent need of a sociology that will among much else check our government's bookkeeping correct picture of our government's need and resources.

In 1992 when the US banks had loaded up with government bonds with no downpayment, the same BIS that made that possible raised interest rates to the skies "to get zero inflation." As a result the 100% leveraged government bonds of earlier date bought entirely on the cuff, collapsed in value, and the system was faced with bankruptcy threatening to pull down the world banking systems with it. A 51 billion dollar stand-by fund was raised to prevent that. But once the emergency had passed Washington realized that the day of low interest rates was over. So what did they do? They introduced accrual accountancy accounting into their ledger. Let me explain: One of the things that the Crusaders – the Templars, I believe – were said to have brought home from the Muslim land the marvels of double-entry accountancy, By the 14th century it had allowed the Venetian Republic to design a form of partnership with Arab traders that respected the basic Muslim principle that to share profit passive partners must share risk. By the next century it had spread over much of Europe. The poet Goethe wrote of it in rapture.

But until 1996 in the US and 2002 in Canada, governments themselves did not use accrual accountancy. That required every transaction to be entered twice, once the money the government laid out for it which was "amortized" over the likely physical useful life of the assets of the investment. But the governments – with the rare and temporary exception apart from Venice did not follow that lead. They "depreciated" the value of the entire investment of the government in a single year and carried it from there on at a book value of a token dollar. If we consult the late François Perroux's "privileged revenue" mentioned a few paragraphs before we will note that it endowed two items with that role – the discrepancy between the token one dollar to which the government asset was depreciated by Year 2 and debt incurred which was "amortized" say over a 50-year period. That led to a net debt on the government books connected with that investment that was not necessarily there. Then if the physical asset is booked at a token one-dollar that could make possible some sensational privatizations, put an end to in January 1996 in the US and the figures worked back to 1959 brought to light capital assets almost one and a quarter trillion dollars.

With that experience behind it, the introduction of accrual accountancy for the investment of human capital today to deal with Vancouver's Downtown Eastside and much, much else would be no high art, but more like cookie-cutter routine. But for that we must restore Schultz's conclusion from Washington's researches after WWII.

There is this about human capital. Well invested, to develop talent, or to handle deep social problems the return is great and keeps coming in generation after generation. The children of educated parents tend to be better educated. The expenditure of the investment in human capital, once recognized, is not only prepaid, but tend to be very much an investment itself.

If ever there was an illustration of the need of more than a tight local responsibility for such problems and promises And what it should tell us is what must somehow squeeze enough money out of the budgets local, provincial, and national it is a thundering argument not only for obtaining contributions from these higher levels of government to the housing, crime, re-educational and general salvage needs of Vancouver's Downtown Eastside, but for a sociological approach that would study its origins, review the accountancy at all levels of accountancy, across the land, study the origins of such problems and the ways of dealing with them before they rot and infect our society as a whole. That would include not only the bases of interchange, but very the system of accountancy of all levels of government so that it will naturally have available – not as a penalty or a debt but as a co-investment of our society across the land. Nor can we stop there in the injection of a due ingredient of sociology.

We must introduce the auditing techniques that will recognize capital investments of governments of all levels, and see that they are properly treated at every level as investments, and human disasters as losses.

William Krehm

Emergency Measure for Repairing Economics Caught in the Storm Sans Compass or Shelter

With the utmost alarm we have been witnesses in recent weeks to further evidence that economics as our universities have come to teach it or even acknowledge to exist has become a spent and ravished discipline. It cries for drastic repairs. The problem is to obtain access to it.

For that purpose I have brought in another parallel discipline – sociology. From ancient Greece on in the work of Plato, Aristotle and others have studied the interrelations of man and society. The discipline was continued since the Renaissance to modern times – by university scholars, some academic polymaths in a variety of physical and social disciplines, others self-taught researchers.

In our growing alarm at the emergencies that the advisers of President Obama are messing up with the innocence of babes, we have begun bringing in the work of millennia of sociologists on how man interacts with his environment to society's needs. For those economists and ordinary citizens who share our anxieties and have no previous knowledge of the literature and purposes of sociology, we recommend as an introductory volume *An Introduction to the History of Sociology*, edited by Harry Elmer Barnes, The University of Chicago Press, Chicago, 1948.

If you wish to join in our effort, dig in! ■

Is Somebody On High Trying to Tell Us Something that We've Been Missing?

Debt had been narrowed down to the one really cutting factor in our society, We are taught to regard it as the ultimate evil, that brings on ruin. Yet just about anyone who really doesn't want to remain a wage-slave, is wrapped up in entangling the rest of the world in debt. But that just adds a final touch to the completeness of the theology. As in most theologies, being able to transfer from one end to the other of the its contrasted departments – from god to devil or back – is simply taken for granted. If your own theological sect won't help you do that, the closest related theological sect is likely to be more than willing to.

So all-embracing has debt become that it encircles us as a complete economic theology – to the point where it can ruin the most wealthy overnight, or be raised to the supreme blessing.

The device for this mobility is simple enough. There was a time in 1933, when Roosevelt, wrestling with how to contain and even reverse the Great Depression, brought in the *Glass-Steagall* law, that limited the amount of debt that banks could create – by the simple device of obtaining control of the other "non-banking financial pillars." These consisted in that remote day of essentially three types of corporations – stock brokerages, insurance, and mortgage companies. And complete theologies must have plenty of conceptual space, particularly under beds, and in clothes closets for deceptive or hidden members of the economic theology bubble must have universal powers for getting around. They do not have to depend on limited terrestrial fuels like gasoline to move from one of creation's corners to the next. The factor credulity overtops simple credibility.

Let us examine a feature or two of the debt theology that has made this atmosphere of miracles impossible today. Not least of these is that debt has long since become the sole active device of the theology. From President F.D. Roosevelt's first inauguration, when thousands upon thousand of banks had already closed their doors, and Roosevelt shut up the rest as well for a whole month until the *Glass-Steagall* legislation had barred the banks from acquiring interests in the other "non-banking financial pillars." In those days it was that simple. Today, of course starting with credit cards, and going on to derivative swaps that insure gambles on future bets on happening that don't even have to do with the real economy. And that still makes no mention of sliced, diced repackaged "collateralized debt," that depends as well on the market-proven value of the collateral as well as on the debt collateralization that defies market value-testing. The resulting huge risks and losses often reach as much as fifty times the volume of anything in the real economy. The gradual ignoring of the *Glass-Steagall* legislation and its formal repeal in 1998, permitted the banks every time they were bailed out from their burden of speculative debt, to acquire an interest in one of these corporations that had been forbidden them. And with that came cash and near-cash (i.e. short-term, interest-bearing debt) that had been banned to the banks. That had been banned to them because unlike the non-interest-bearing debt of the central treasury or of the central bank that bore no interest its market-value did not inflect inversely to that interest rate.

Another Balancing Tool to Prevent a Monopoly of High Interest as Stabilizer

But the benchmark rate set by the central bank for overnight borrowing between banks for loans between private banks to meet their obligations to the central bank was carefully balanced by another non-interest-payment, but the proportion of deposits received by private banks that had to be redeposited with the central bank on a non-interest-paying basis. Rather than varying interest to help control the economy, this provided a second means of controlling the pace of the economy. The statutory reserves depended on the amount of interest-free redeposit with the central bank that the private bank had been obliged to make. View that as an alternative means of adjusting the economy to unused capacity that was the statutory reserves that banks had to leave with the central bank on which they received no interest. The effect of that on interest rates and activity throughout the economy was primarily on the *volume* of lending it made available and not on the *rate* of interest. The important thing about that two-pronged control of the economy was that it denied the *rate of interest* monopolist powers for controlling the economy. The abolition of the statutory reserves seriously rattled the equilibrium in the theocratic control capsule between the gods and the demons.

But there was more strife ahead. And it concerned more than interest rates on what, where, and when. It had to do with basic principles of accountancy that governments impose on private corporations and citizens unless corruption unofficially has taken over. In the theocratic capsule it took over from the very beginning. When a private corporation makes an investment of a strictly physical nature, the cost, whether financed or paid in cash, is *amortized* over the likely useful life of the asset, while the value of the asset itself is *depreciated* over the a similar period. That is known as "accrual accountancy" and was brought back to Europe by an order of Crusaders from Muslim lands some thousand years ago. It formed the basis of the Venetian Republic's trading with the Arab countries – it observed the Muslim religious concern about having only if they shared in the risks of an enterprise being able to share in the profits sharing of risks by those investors being able to share in the profits.

That, however, has not been the case with the governments' accounting in Europe until recently. Rather, the debt incurred or the cash invested by the government was *amortized,* say over a half-century, but the physical asset was *depreciated* in a single year. That produced a budgetary deficit that was not necessarily there. But it did serve a highly useful couple of purposes for those in the saddle. However, all budgetary deficits, like all efficient devils, wear horns – usually in pairs. And having capital investments on the government books listed at a single dollar, permitted some sensational privatizations for the well-connected.

The Brief Celebration of Theodore Schultz

That faulty accountancy not only introduced some very misdirected bookkeeping into the books of our theological bubble, but it completely buried one of the most important lessons brought out of the Second World War. Countless times we have

explained how at the end of the conflict Washington had sent hundreds of economists to Japan and Germany to predict how long it would be before those two great defeated powers would become once more the formidable traders on world markets they had been. In 1961 one of these economists, Theodore Schultz, explained why their predictions had missed the mark so badly. "We concentrated on the physical damage, overlooking that a skilled and disciplined work force had come out of the struggle virtually intact." To announce this conclusion, Schultz published a paper in 1961 concluding that human investment in human capital is the most productive investment a government can make. For a few years he was feted and decorated, and then systematically forgotten by the theocratic bubble.

For even in the present deepening crisis when more and more serious citizens are urging more spending more of our budget on absorbing the growing number of unemployed by reeducating them and the younger generation. However, what is not mentioned is that rather than a current expenditures as is presented, that is would be an *investment* – according to the buried Schultz law – the most productive investment a government can make.

More than that, almost invariably what is being proclaimed an expenditure giving rise to a budgetary deficit, would be an investment with the unusual feature: the very expenditure of the prepaid investment in most cases is itself an investment. The children of educated parents tend to be better educated, healthier and better adjusted socially. Obviously environmental care falls into the same category.

What we are confronting, then, is a major mess-up in the theocratic bubble, and the distinction between current expenditure and key capital investment, giving rise to a sequence, and a lineage of most important government investment, is doddered over with endless doubts of "Can we afford such 'spending.'" Socially this can be lethal, for it leaves rearmament with the highest possible technology the only course likely to achieve the blessing of the theocratic bubble. Even, sad to say, in the Obama camp.

William Krehm

RENEW TODAY!
(SEE PAGE 2)

In Search of New Resources — We Turn to Sociology

My source for this appraisal of one of the great founding fathers of the French sociologists is the book of Raymond Aron – *Les étapes de la pensée sociologique – Montesquieu, Comte, Marx, Toqueville, Durkheim, Pareto, Weber* (Gallimard, 1967.)

In a general way sociologists chose to start their thinking about society from a preconceived concept of what the economy can and should be. Towards that end they attempt to understand what society is, how its organization arose, and how it may be changing under our very eyes. At the same time they depend on their ability to grasp of what is happening to understand the process, whence it has come and where it might be headed. That means that they must seek, and usually succeed up to a point, and may fail in others. It is difficult for any researcher to step out of his skin and habits, to achieve as completely "objective" view of his society. However, to grasp the need for such disciplines, be they only heroic and partly successful attempts are tremendously vital, especially when the world economy has been blindfolded and spun by emasculated theories that have already led to mounting disasters.

Since we will be dealing with the work of Emile Durkheim, let us begin with the bare facts of his life span. Born in 1858 at Epinal in France, into a family of rabbis, studied at the École Normale Superieure on a scholarship and continued as Professor of philosophy in Paris, then in Germany under the great experimental psychologist Wundt.

"In his way of analyzing of the leading ideas of the three great books of Durkheim, the reader cannot but be impressed with the similarity of the methods he employed on very distinct subjects and hence not surprisingly in the results obtained. In his *Division of Social Labour* as in *Le Suicide*, first comes a definition of the phenomenon studied, then the refutation of earlier interpretations; finally, a properly sociological explanation of the phenomenon is considered. What is involved are individualist and rationalizing interpretations, of the sort familiar to us, in fact, from the work of economists.

In *The Division of Social Labour,* Durkheim dismisses the interpretation of progress through the mechanisms of individual psychology. He shows that one cannot explain the social differentiation towards increased productivity by the pursuit of pleasure and happiness, or the attempt to overcome boredom. In *Le Suicide* the explications that he sweeps aside are also individualist and psychological. Finally, in *Les Formes élémentaires de la vie religieuse,* the refuted interpretations are those of animism and naturism, because they assume society's priority to individualist phenomena.

In the three cases, the explanation that he is left with is essentially sociological, although the meaning of that label may have a distinct meaning in each of these cases cited.

Assumption of Society's Priority

In *The Division of Social Labour* he assumes the priority of society over individual phenomena. In particular what is brought to the fore is the volume and density of the population. In *Le Suicide*, the social phenomenon by which he explains suicide is what he calls the "suicidigène current," or social tendency to suicide, incarnated in certain individuals because of his individual reasons. Finally, when it is a question of religion, the sociological explanation has a double character. On one hand, there is a collective exaltation arising from the gathering of individuals in the same place that gives rise to a religious phenomenon, inspiring the sense of holiness; on the other hand, it is society itself that the individuals adore without realizing it. Sociology, as conceived by Durkheim, is the study of essentially social facts, and the explanation of these facts in a sociological manner.

The Durkheim concept of sociology is based on the theory of a *social fact.* Durkheim's goal is to prove there can and must be a sociology that is an objective science, just as in the case of the other sciences. Therefore two things are needed for that. This double requirement leads to the two celebrated formulae by which the Durkheim doctrine is summed up: social facts must be considered "things"; the characteristic of the social fact is that it exercises a constraint on individuals.

This tendency to represent social facts as susceptible of being classed in different categories and species. This Durkheimien practice is based on the principle that societies differ by their degree of complexity.

The point of departure here is the simplest human aggregate that Durkheim calls a "horde." This group is perhaps a historic reality but possibly only a theoretic fiction, and is suddenly resolved into individuals juxtaposed in what one might term an atomic manner. The horde thus ends up occupying the position in the social kingdom comparable to that of the protozoan among animals. After the horde comes the clan that may comprise several families. But, according to Durkheim, families come after the clan and do not consist of several families. According to this concept, there would be simple social units whose joining would give rise to the various social types. The societies that can be broken up into the various social types. Accordingly each society would be defined by its degree of complexity and that would permit the determination of a given society's nature without referring to the historic phases it has passed through such as the stages of economic development.

Durkheim elsewhere asserts – with respect to Japanese society – a society may absorb a certain economic development of foreign origin without changing its fundamental nature.

The sociologues of the 19th century, August Comte and Karl Marx attempted to determine the key moments of historic development and the intellectual, economic, and social development of humanity. According to Durkheim such efforts lead nowhere.

The distinction between what is normal and what is pathological, developed in Chapter III of the *Règles de la méthode sociologique* fills a key role in grasping Durkheim's thought processes. In my opinion the above distinction will remain of the foundations of Durkheim's thinking. Durkheim's determination to be considered a "pure scientist" did not prevent him from stating that sociology would not be worth an hour of effort if it did not make possible society's improvement.

According to Durkheim, a phenomenon is normal when it is generally encountered in a society of a certain type, at a certain point of its career. Crime is therefore a normal phenomenon or, better said, a certain rate of crime is.

Just as normalcy is defined by the generality, the explanation, according to Durkheim, is defined by the cause.

This theory of scientific sociology is based on a principle at the very crux of Durkheimian thought: society is a reality distinct in nature from the individual realities. Every social fact has as its cause another social fact and never a fact of individual psychology. Everything is on the screen or the blackboard. Previously unacknowledged facts simply do not count.

Durkheim is much more highly rated for his contributions by other sociologues than he is by Raymond Aron, but his criticism is particularly helpful because it reveals how the encroaching habits of dominant disciplines – economics in this case with all its multiple weaknesses.

Sociology and Socialism

Undoubtedly, many critics have remarked that Durkheim worked on behalf of sociology, while he had been trained as a philosopher rather than as a sociologist. He spoke of sociology with the moral zeal of a prophet. On the other hand, his sociology conveys a vision of modern man, society and of human history. But one can argue that all the great sociological systems embrace a conception of man and history. I will direct my criticism on the concept of society or on the different senses in which Durkheim uses the word "society."

Durkheim wished above all throughout his life to remain a positive thinker and scientist, a sociologue able to consider social facts as "things." and to handle them much as specialists in the natural sciences do appearances. Thus every critique of Durkheim must insist on this duality concerning society.

Society is thus defined as the social milieu and considered as the determinant of the other phenomena. Durkheim insists, with good reason, that the various institutions such as family, crime, education, politics, morality, religion, are conditioned by social organization. But he tends to take the social milieu as a total analytical category, rather than an ultimate cause. He is inclined to take the social milieu for a very special reality, objectively and materially defined, whereas it is only an intellectual concept. This tendency to structure abstractions into real forces appears in his notion of the *suicidogenous* current that features in Durkheim's vocabulary. Suicide statistics are larger or smaller according to the conditions among particular groups. In no way can it be taken to mean that desperate people kill themselves because they are carried away by a "collective suicidal current."

The Durkheimien way of thinking is closely associated with the French socialists of the late 19th century. According to Marcel Mauss, Durkheim's nephew, it was Durkheim who influenced Jaures to move in the direction of socialism, emphasizing the advantages of socialism over the poverty of the radical programs of that period to which Jaures subscribed.

As for Durkheim's brand of socialism, he at no time believed in violent means and he refused to consider the class struggle, especially the struggle between workers and their employers as an essential tool of a true socialist.

Our brief review of one ideologist's review of illustrates their difficulties in coping with the degenerate schools of economics in a world economy ransacked and squeezed black, blue and bloody by the marginalist economic theory gotten wholly out of hand. That could help in designing a way out of the engulfing world mess.

William Krehm

Protectionism

Barack Obama has stated that the present economic models are preferable to protectionism because protectionism is "beggar your neighbour" policy.

I wonder how he can imagine that the present globalization and free market policies have not beggared our neighbours when you recall that about 2 billion people now live on less that two dollars a day and that was before the present economic chaos.

There is a number of ways against which global society needs protection:

- unemployment and underemployment
- low wages
- poor health conditions
- polluting contamination
- loss of land
- degradation of fertile land
- loss of traditional farming
- loss of or loss of control of mineral resources
- loss of human and economic rights
- loss of sovereignty and decision-making
- loss of freedom
- loss of languages and cultures
- loss of common goods, e.g., water
- loss of educated people moving to the First World

Only localization and empowerment of grassroots organizations can restore some sanity to our global systems. Re-establishing the old systems with tax-payer largesse will not stop the "beggaring our neighbour" process.

Shirley Farlinger

What a Hacked-up World Market is Trying to Tell Us

Like Caesar in the forum after the stabbing – "Et tu Brute."

If we open our minds, only one conclusion can emerge: "Deregulation and Globalization" suited the banks fine so long as it lasted because they were imprisoned in that ever unfinished skyscraper that they went on building at an ever accelerating pace. This was achieved by laying hands on the reserves of the non-banking financial pillars that President F.D. Roosevelt had barred to them. For good enough reason. Give them access to the cash and near-cash (i.e., interest-bearing) reserves those other pillars needed for their own business – stock brokerages, insurance and mortgage companies – and the banks would use them as cash-base for issuing ever further storeys of their own-created interest-bearing debt. This was not to be mistaken for cash since its market value varied inversely with the benchmark money rate set by the central bank.

So what resulted were financial skyscrapers with storeys piling up ever more rapidly and with elevators that could only rise – at an ever accelerating clip – never descend. Descent would be tantamount to surrender and bankruptcy. The concept – like so much of the thinking of those in power – had been borrowed from our technology. In this case from the exponential function that was the mathematics of the atomic bomb.

That was very simply constructed – the sum of an infinite series that begins with a single constant 1 and then goes on with each successive term of the next mathematical degree higher right into infinity. The essence of that structure is that with each step in the series, the power of the variable on the extreme left becomes zero. 1 cannot change its value for it is a constant. But no reason for alarm what we are dealing with is an *infinite* series – each time it loses a constant term on its extreme left at the new beginning of the series, original term being a constant linear multiple of "x," becomes a constant to replace it. In fact the term it picks up say a continent away if need be would be of far higher order than what it has dropped at the beginning. So there remains only the determination of the coordinates of each successive term of the series. This has to be set precisely to give the users of the atomic bomb control over it. That is settled by having the coordinates of each successive term set so that term moves exactly one space towards infinitely distant end of the series. That in turn is translated into physical terms by setting the strength of the atomic explosive in each so that it will continue precisely the same infinite series that moves one step to the right and leaves control in the hands of those who launch the weapon. This is translated in the case of the atomic bomb by making sure that the harmless zeroes will end up at the launcher's end and turn no corners. That can be handled in the case of the bomb by translating the coordinates of each successive term into the mixtures of atomic material needed for the purpose.

The Hoax of Risk Management

But these are precisely the skills and even the understanding that was lacking in the deregulation and globalization aspirations of our world banking community that otherwise owed so much in general inspiration to the atomic weapon. "Risk management" as they used the concept merely meant that they shifted the risk endangering a good profit to others. This was achieved by buying insurance or reimbursing themselves by selling subprime mortgages cum insurance. Such insurance grew to something like 50 times the total of the subprime collateralized securities it was supposed to insure. And that, too, is why the whole subject of derivative swaps and other derivative concoctions became taboo even at many economic conferences of the most prestigious universities. It constituted a secret not unlike that surrounding the atomic bomb itself.

There is thus no retreat from this ongoing disaster without grasping the atomic model for globalization and deregulation. The sooner that President Obama grasps this and chooses advisers capable of restoring the Rooseveltian restraints on our banks, the better.

It will also require a widespread knowledge of our most crucial history. Thus in 1992 when the Bank for International Settlements had painted itself in a corner in its effort to help the American banks out of their headlong losses in taking over the Savings and Loans mortgage trusts, the BIS declared the debt of developed countries risk-free and hence available to governments of such countries to acquire such bonds without down payment. Clearly to fill empty coffers. But in 1992 the same BIS declared that nothing less than "zero inflation" would be acceptable. At the same time, however, the BIS pushed interest rates into the heavens to finally "lick inflation." But what escaped the attention of the BIS and the legions of bankers around them was that when you raise interest rates into skies, all preexistent debt with lower interest coupons collapses in value.

When the reality hit them, it had already threatened to bring down the world monetary system. The largest standby fund was put together to that date to prevent the collapse of the financial community. The fright it gave Washington, however, conveyed the message to the Clinton government that the era of high interest rates was over. So chastened, Washington set about cleaning house more seriously.

Up to then practically all governments – with the temporary exceptions of a couple of Scandinavian countries. conscientiously entered into their books the cost of a government investment, and "amortized" it over the likely useful life of the acquired asset. However, the physical assets acquired in this way were entirely *depreciated* in the first year of the investment and thenceforth carried on its books at a token dollar. This was called prettily "cash accountancy," but it was of course a swindle for a couple of reasons: it resulted in a government deficit that was not necessarily there, but served as an argument for slashing social services. And then, of course, it led to some heroic privatizations that could be sold at huge profits to the well-connected.

As a result of this scare nearly bringing on a world-wide financial crisis, the Clinton government decided that the days of high interest rates were over. It set about bringing in serious accrual accountancy (also known as double-entry bookkeeping) into its books. The physical assets of government investments were accorded a "depreciation" period at least similar to their likely usefulness. Carried backward to 1959, some $1.25 trillion dollars of previously ignored physical investment was revealed. And that brought down interest rates substantially. The assured Clinton his reelection and the high tech boom that with grotesque frills went on climbing until its bust in 1998.

That was already achieved under great duress. Having accomplished this once before with the government's physical investment's there should be no difficulty in

duplicating the move with respect to the government's investment in *human* capital.

That is particularly so because one of the most positive things to come out of World War II was the realization that human capital is the most productive investment a government can make.

It was one of the most costly studies made *in situ* to that date. Hundreds of economists were sent to Japan and Germany by Washington to assess the damage and from it predict how long it would take Japan and Germany to become the formidable traders they had been on the world market. In 1961 one of these scholars, Theodore Schultz of the University of Chicago presented his conclusions. "It was remarkable how far off mark we were. Clearly we had concentrated on the physical destruction and overlooked that the work force had come out of the conflict largely intact." From this Schultz concluded that investment in human capital – education, and hence health, the environment that a government can make. A notable feature is that in "spending" this prepaid capital, constitutes a key investment itself rather than just "spending." Great Britain is still receiving a decent return on whatever England's outlay had been in teaching Newton mathematics or Shakespeare the art of writing.

For a few years, Schultz was decorated and honored for his great discovery. But before long his very memory was trashed except for a few brave souls like those in COMER. His fate, dreadfully costly to humanity around the world, is suffering because of the suppression of an idea of another great forgotten economist, François Perroux of France. Amongst much else Perroux is eternally relevant because of his theory of the "dominant revenue." This holds that in every society the income of an empowered class comes to be seen as the "dominant revenue" by the volume of which the welfare of society as a whole can be gauged. What happened to Schultz's realization that human investment is the most fruitful a government can make is that it contradicted head-to-toe the dominant revenue of speculative finance that sees the profit of multi-tiered banking as the dominant revenue today.

That explains why those in the saddle today, most regrettably including President Obama pay lip service to the importance of education, health, the environment, but always as expenditures, and never as prepaid investments *whose return is the greatest that a society can make*. The debt that haunts them – as every economist should know is a jumble of many very disparate things. With the end of the gold standard the debt of our central governments – above all in developed countries – is the only legal tender in existence. Mix it up with private promotions and you produce a messed-up subprime currency of the land. Another great part of the seeming debt is investment in human capital – wondrously documented by Schultz as the most profitable a government can aspire to. However, though across the land we are hearing more and more voices advocating more employment in education, health, environmental care, it is always as regrettably sources of debt rather than the expenditure of already made public investments for even greater return.

What we need are a trio of teachings: Schulz, Perroux, and on banking, the Rooseveltian *Glass-Steagall* legislation that drew a reserved line around stock brokerage, insurance, mortgage corporations, credit card enterprises, as incompatible with simple banking. And above all the legal tender of the land created by the central bank financing the investment needs of the central government. Of course, directly through the central bank or through the central government other levels of government must have access to this interest-free financing.

William Krehm

Correspondence

August 20, 2008

Robert J. Zimmer, President
University of Chicago
Administration 501, 5801 South Ellis Ave.
Chicago, IL 60637

Dear Dr. Zimmer:

I am writing to register my opposition to the establishment of a Milton Friedman Institute and to make a suggestion.

Simply put, the ideological commitments of a Friedman institute would contribute to perpetuating the problems for economies and societies of the same sort that so many mainstream economists, including Milton Friedman, have foisted on the unsuspecting at home and abroad.

As I see it. John Dewey made the essential point. Dewey said "The transition from an ordinary to a scientific attitude of mind coincides with ceasing to take certain things for granted and assuming a critical or inquiring and testing attitude."[1]

The economic and social system to which Friedman adheres is fabricated by him and those associated with him – by assumption – to be of a free-market minimalist government sort. What is assumed *is not just taken as given* by him and others of his stripe, but as *appropriate for all times and places and peoples.* This renders Friedmanist and mainstream projects inconsistent with both the concept of University and with that of science. In reality there is no free market,[2] institutional power dictates and race, culture and history matter.

The way out is to make the economic and social systems that exist in reality the subject of interdisciplinary investigation that is open ended, inquiring and critical.[3] Such investigations will inevitably require a proper intellectual base in human values that are acceptable at home and abroad. The United Nations Universal Declaration of Human Rights, in the construction of which Eleanor Roosevelt was prominent, would seem to have such acceptance.

While I am sure that some of what is suggested here is already taking place. I nevertheless recommend that the University of Chicago formally turn its attention and resources to this wider university humanitarian perspective and away from the establishment of a Friedman Institute.

I attach two documents you might find of relevance: "Reforming Economics – Ten Quick Steps towards Reality Economics," http://economics.uwaterloo.ca/needhdata/Reforming%20EconomicsSteps%20to%20Futher%20Reality%20Economics2.pdf, and "Gatekeeper Economics and the Reality of Economy and Society (Draft)", http://economics.uwaterloo.ca/needhdata/Econ-Society.pdf.

Yours sincerely,

W. Robert Needham
Professor Emeritus
Department of Economics
University of Waterloo

1. Dewey, John, "Logical Conditions of a Scientific Treatment of Morality," *Decennial Publications of the University of Chicago*, First Series, Vol. 3, (1903): 115-139. http://www.brocku.ca/MeadProject/Dewey/Dewey_1903.html.

2. See: Reich, Charles A. *Opposing the System* (New York: Crown Publishers, Inc., 1995).

3. See further: Needham W. Robert, Reforming Economics-Ten Quick Steps towards Reality Economics: http://economics.uwaterloo.ca/fac-needham.html. Published in COMER, July 2008.

Refresh Your Memory of Your Country's History to Help Control What Lies Ahead

We will start just where *The New York Times* (22/02, "Blood on the Street" by Kevin Baker) closes its review of an early Wall Street explosion: "Even now there remains a tendency to think of violence as an anomaly, something outside the American experience, rather than as one of the many ways the Americans have long carried out their political disputes.

"Human memory simply hasn't the capacity to hang on to the self-inflicted violence employed in settling its destiny. But on with the tale which faintly lurked on like the memory of early tenants in a rented apartment. We put down our copy of the review with a better idea of why the living room window is cracked and traces of a botch repair in the living room ceiling.

"At the stroke of noon on September 16, 1920, a bomb exploded along Wall Street, killing 38 people and maiming hundreds more. It was the worst terrorist bombing in the US until the Oklahoma City attack in 1995, the worst in New York until the 9/11 attacks on the World Trade Center.

"The bomb was an immeasurably cruel device, most likely dynamite tied to iron sash weights that acted as shrapnel. It blew people apart where they walked out on a cool, late-summer day, tore arms and legs, hands and scalps off living human beings. Others were beheaded or eviscerated, or found themselves suddenly engulfed in flames. Still more injuries were caused by a cascade of broken glass that followed.

"The bomb's target was presumed to be the House of Morgan, which sat like a blockhouse just across the street from where the explosive had been left in a horse-drawn wagon. The Morgan bank had emerged from World War I as the single most powerful financial institution in the world, and both the financial institution and its principals had been under increasing attack, rhetoric and otherwise, ever since it had arranged a huge loan a few years before to help the Allies and keep the Great War going. But the only fatality inside the firm was a 24-year-old clerk. Nearly all the bank's employees were back at their desks the next morning, some of them still bandaged and bruised. The explosion merely pocked the firm's impenetrable, marble walls, the marks defiantly left where they can be seen to this day: 'the stigma of capitalism.'

"As with all terrorist attacks, most of the victims were innocent bystanders, 'messengers, stenographers, clerks, salesmen, drivers,' men and women for whom 'Wall Street was not a grand symbol of American capitalism' but 'a place to make a modest living selling milk, driving a car, typing reports, recording sales.' Only seven of the dead were over the age of 40. Five were women, four teenagers.

"A bevy of the nation's most prominent lawmen and private detectives immediately descended on Wall Street, blaming first anarchists, then paid agents from Lenin's new government in Moscow. But years of investigation yielded nothing – no indictments, no trials, no culprits. No one ever came forward to take responsibility for the crime, or to state what it was supposed to accomplish, and before long it had dropped from public view, lost among the sensations of the racing, giddy '20s."

Dropped from Official Memory

"Beverly Cage, a writer and history teacher at Yale, has brought the bombing to life again in her outstanding first book, *The Day Wall Street Exploded.* Gage also does us the great good service of placing it in the wider history of industrial warfare that once proliferated in America. Like much of American history, these battles have dropped out of mind because no one wanted to look at them too closely. The right was loath to discuss the decades of brutal labor and political repression that preceded the bombing, the left to admit that extremists were willing to resort to violence to overthrow the capitalist order.

"Between 1881 and 1905 alone, there were more than 37,000 labor strikes in the US, many of them bloody, bitter struggles. Efforts to unionize were routinely met with clubbings, shootings, jailings, black-listings and executions, perpetrated not only by well-armed legions of company goons, but also by police officers, deputies, National Guardsmen and even regular soldiers. Dozens of workers were killed in these conflicts – at Ludlow in 1914, in the Homestead and Pullman strikes in the 1890s, at Telluride and Cripple Creek and Colorado Springs.

"Some unionists, seeing the state aligned with the employers, struck back with dynamite, invented in 1866 and readily available at construction sites. In Idaho in 1905, a bomb ripped the legs off Gov. Frank Steunenberg in his own front yard after he stuck a thousand miners from the Coeur d'Alene strike in makeshift jails for months without trial.

"Twenty-one men died when labor radicals blew up the rabidly anti-union Los Angeles Times Building in 1910. Relatively few workers were involved in such outrages, but millions did turn to the Socialist Party and the far-left Industrial Workers of the World (the Wobblies), organizations that promised to sweep away the entire capitalist system. 'Far from being an era of placid reform,' Gage writes, 'the turn of the century was a moment when the entire structure of American institutions – from the government to the economy – seemed to be up for grabs, poised to be reshaped by new movements and ideas.'

"A murky underworld developed, one in which some radicals – particularly the small but implacable cells of anarchists – really did plot assassinations and bombings, while companies tried framing strikers with phony bomb plots and other accusations.

"Things came to a head when America entered World War I and the ostensibly progressive Wilson administration put aside the Constitution, jailing thousands of dissidents and suppressing the antiwar Socialists and Wobblies. On June 2, 1919, a new wave of bombs hit in apparent retaliation, including one that wrecked the home of Woodrow Wilson's Attorney-General, A. Mitchell Palmer, who opportunistically used the incident to start the nation's first 'Red scare.' It became one of the most shameful campaigns in the country's history, with hundreds deported merely on suspicion of having radical proclivities. In perhaps the worst episode, an anarchist named Andrea Salsedo was found dead in his underwear on the sidewalk of Park Row in New York, below a room where the Bureau of Investigation – predecessor of the FBI – had secretly held him for weeks.

"Four months later came the Wall Street bomb. What few clues there were pointed to Salsedo's comrades, members of a particularly ruthless anarchist group called the Galleanisti, named after its founder, Luigi

Galliani. But the Red hunters had done their work too well, having already deported Galleani and many other potential witnesses.

"Even though the crime was never solved, it had other repercussions. The bungled investigation and its wholesale violation of people's civil liberties, as Gage shows, led to a major house-cleaning of the Bureau – which paradoxically enabled the rise of the biggest civil liberties violator in American history, J. Edgar Hoover. And the bombing contributed to an atmosphere in which two other anarchists, Sacco and Vanzetti, were convicted of murder in a case that would become the leftist cause of the decade.

"Over time, the bombing petered out, though organized violence in labor and other disputes continued. Even now, as Gage writes, 'there remains a tendency to think of violence as something, something outside the American experience, rather than as one of the many ways Americans have carried out their political disputes.'"

It is crucially important to safeguard our future by clinging to the realities of our past.

W.K.

A Posy of Splitting Headaches

The crisis of the world economy has a murderous cutting edge of many dimensions. *The Wall Street Journal* (14/01, "Taking Stock: Inventory Data Augur Troubles" by Mark Gongloff) introduces a refinement of inventory problems that tracks yet another economic headache: "Another problem for the economy could be piling up in the stockroom of the local grocery store.

"On Wednesday morning, the Commerce Department reports manufacturing, wholesale and retail inventories for November. It is relatively ancient history; only retail-inventory data haven't been previously reported. So the market will probably pay more attention to the Federal Reserve's 'beige book' report of economic anecdotes and the Commerce Department's separate report on retail sales, also due Wednesday. Both will likely be awful.

"Still, the trend in inventories could speak more to the economy's trajectory than the other data points. Economists, on average, think inventories shrank in November for the third month in a row. As fast as inventories have fallen, however, sales are falling even faster. The ratio of inventory to sales has jumped in recent months to its highest level since 2003.

"The inventory-to-sales ratio had fallen more or less steadily for more than a decade, as new technology helped businesses operate more efficiently. The recession has been swamping those gains – even before it intensified in November.

"'Businesses are trying to keep inventories under control, but they're chasing a moving target,' said Joshua Shapiro, chief US economist at MFR Inc. Demand is falling so rapidly, its becoming very difficult to keep up.

"The Commerce Department's inventory numbers aren't adjusted for inflation, meaning that in some instances the dollar value of inventory is falling while the owner is sitting with the same stock. Vanishing sales have left unsold products on car lots, in retail stores, and tankers and elsewhere.

"All that inventory will keep downward pressure on prices, as businesses try to clear their decks with heavy discounting. And it could lead to more cuts in production and payrolls."

Blue Chips Slip 25.41 Points as Earnings Pressures Grow

"The Dow Jones Industrial Average finished down 25.41 points at 8448.56, its fifth straight decline. Bank of America fell 6.8% after a Sandler O'Neill analyst became the latest to cut his fourth-quarter earnings estimate. General Electric was down 5.6% after a Barclays analyst warned that fourth-quarter results could come in at the low end of the company's projections. Alcoa fell 5.1% on the heels of the quarterly loss it reported after Monday's close.

"In a London speech, Federal Reserve Chairman Ben Bernanke said the timing and strength of the global recovery 'are highly uncertain,' which some traders took to mean that stocks could languish for years to come.

"Citigroup, which fell 17% Monday, rose 5.4% after a report that it is repairing a major reorganization that will undo large pieces of the financial supermarket that was created in 1998.

"The Standard & Poor's 500-stock index eked out a 1.53-point gain to close at 8771.79."

From the same issue of *The Wall Street Journal* crowded with the grief of a deregulated world ("UK Widens Stimulus Plan But Still Faces Lending Gap" by Carrick Mollenkamp, Alistair MacDonald and Sara Schaefer Munoz) we cite: "The UK government is racing to expand a financial-rescue plan that so far has failed to spark economic revival. But it faces a tough new problem getting its domestic banks to fill the huge lending void left by foreign firms that have fled the market.

"British Prime Minister Gordon Brown and Treasury Chief Alistair Darling are preparing an enhanced lending plan that will be announced Wednesday, the government said. A key part of the new package is expected to be a £20 billion ($29.65 billion) loan-guarantee program aimed at small-and-medium-size companies according to people familiar with the situation.

"Messers. Brown and Darling, however, face a tough reality as they seek to amend the original rescue package. No matter how much they pressure UK banks to lend, it won't make up for the gap left by the financial damage to lenders in places like Iceland, Ireland and Belgium. The UK banks are also hampered by their own growing corporate losses, as well as the fact that there still is no market for securities made up of pools of consumer loans."

A clear case of globalization and deregulation being better suited for creating ever growing headaches than clear profits.

"As they launch the revised plan, UK leaders, hailed in the autumn as architects of a smart bank-rescue plan, now will face tough questions as to why the hurriedly organized £500 billion package has failed to revive bank lending. But increasingly, foreign banks such as Fortis NV, the Dutch-Belgian concern, as well as a clutch of Icelandic lenders, are shutting off credit or going out of business.

"Tom Rayner, a banking analyst at Citigroup, said in a report that he expected non-UK bank lending to contract as other foreign governments start to incentivize their own banks to lend domestically.

"That means more pressure has fallen on UK banks to lend at a time when they are facing increasing corporate losses. The October rescue plan injected £37 billion into Royal Bank of Scotland Group PLC I, HBOS PLC, and Lloyds TSB Group PLC in hopes those banks would regain solid

footing.

"But banks such as HBOS have been hit by an unexpected rate of corporate defaults. The banks sent a warning in December when it said impairment charges tied to souring loans in October and November rose by £1.6 billion, nearly equal to total for the first nine months of 2008. Much of the charge was tied to commercial property.

"A lack of credit has spread to successful firms. Six months ago. Chris Quickfall, owner of a northern England technology consulting firm called Invate Ltd. said HSBC Holdings PLC, one of the UK's healthier banks, pulled an overdraft facility that Invate hadn't used. 'Banks are looking after No. 1 and that is themselves, leaving businesses out in the cold,' said Mr. Quickfall, whose firm's profits have increased steadily each year since it was launched in 2006, thanks in part to reliable government work."

It will take a lot of slogging before the world recovers from the deregulated globalization that provided the playground for derivatized speculations.

W.K.

Credit Dearth Rarer Than Hen's Teeth is Changing the Very Topography of Stock Trading

It used to be that for banks and brokerages a trader was a trader and no commission reeked unpleasantly. No longer is that quite so. For with financing so hard to come by – one could say for banks at times even more so than the ordinary trader, a discontinuity – a miniature Niagara Falls has begun inserting itself as you approach the $3 a share price below which – be it by a penny when a stock cease being marginable, and the trader has to come up with its entire value. Your bank or broker is likely to shove you away from crossing that limit – if you are on your way down, and encourage you to linger on the down-side where the total problem of finding the financing for your trade rests with you rather than with the bank or broker. That also tends to create a sudden drop rather like a hanged citizen falling through the trapdoor.

Since this injects new rhythms into trading it shakes even what remnants of confidence in such exotic concepts remain. A cruel no-man's land has suddenly appeared below the area of marginality of stocks.

The Wall Street Journal (23/02, "Controlling Swaps' Risks Is Still Vexing" by Serena Ng) deals with other such changes in the topography of the market.

"The latest problems of large US banks are raising the same fears that gripped some markets in the fall. At issue, slow progress in solving the problem of counter-party risk in the credit-derivatives market."

The reference is to swaps trading under which someone who wishes to gamble on a security rising or falling to a certain level simply finds a "counterparty" to sell him insurance supporting his bet, i.e., better that the opposite will happen. What gives him the bravery and the lack of care to do so is to a large extent the derivatives that cheer him on, and the mistaken notion that mathematics has access to empirical information. The fact is that maths have marvelous powers to analyze data of any situation that you properly apply them to but bring no assurance that the circumstances that existed in the past will still be valid. That is why even at leading economics conferences, at universities as distinguished as that at Cambridge, dealing with the validity of derivatives has not exactly been encouraged.

As a result of which the derivative business has thrived, achieving 50 times or more the volume of the sort of operation that is being insured against.

And of course when the counterparties, swarming in their sheer numbers, disappear when they are most needed, the insurance disappears. That adds to the tenuous nature of our already wobbling financial system.

Returning to *WSJ:* "On Friday, as the shares of Citigroup Inc. and Bank of America Corp. fell and nationalization fears drove down bond prices, the cost of insuring their debt from default rose to levels not seen since the height of the financial crisis last year. At the same time, an index that measures counterparty risk of global financial institutions rose to its highest level since October 10. The index, run by Credit Derivatives Research LLC, reflects the cost of protecting the debt of banks and brokerages from default.

"Meantime, efforts to reduce counterparty risk by setting up central clearing for credit-default swaps are moving slowly as regulators, exchange operators and clearing-houses in the US and Europe jostle for as role in the $30 trillion market."

Jostling for Swaps-clearing Houses

"Despite months of high-level discussions and industry preparations, most swap-clearing-houses haven't opened for business since many details are still being worked out and regulators have differing views on how to regulate the market, One credit-default-swap venture that went live in late 2008 has had virtually no business because dealers that currently handle most derivative trades want to support other initiatives.

"Credit-default swaps are private contracts that act like insurance against bond and loan default. They are currently traded between individual firms.

"A central clearinghouse would help solve the counterparty problem because it stands between the parties in a credit-default-swap trade, guaranteeing the respective obligations of the individual firms. By acting as middleman, the clearinghouse would cushion the impact of a default of one party, preventing the collapse of one firm from sparking huge losses at others.

"Many financial institutions that are large sellers of credit protection are themselves facing crises of investor confidence. That's limiting swap trades in the broader market because hedge funds and dealers don't know if they can count on their counterparties to provide the protection they need.

"So far at least three separate credit-default-swap clearing-houses are being developed in the US by exchange operators Intercontinental Exchange Inc., CME Group Inc. and the derivative arm of NYSE Euronext. In Europe, at least four rival efforts are under way including a plan by IGE whose proposed clearinghouse in the US has the support of major derivative dealers. Regulators in France last week argued for having separate credit-default-swap counterparties in different regions.

"Regulators are trying to better coordinate their oversight of swap clearinghouses in the meantime. Last week, a statement from the Federal Reserve Bank of New York said a group of at least nine regulators on both sides of the Atlantic have agreed to cooperate, apply consistent standards and support each others in efforts to regulate the credit-default swap market."

William Krehm

The Survival Plan of The New York Times, Our Key Source For This

Like much else, newspaper technologies are on the brink of bankruptcy and change. As though for our convenience in writing this brief review we quote from its article "The Times Seeks Opportunity Despite Toll of a Recession" by Richard Perez-Pena: "In a conference call with analysts late last month, Janet L. Robinson, the president and CEO of The New York Times Company, laid out her vision of how the company may survive the downturn crippling the industry.

"'As other newspapers cut back on coverage, or cease operations, we believe there will be opportunities for the *Times* to fill that void,' she said. Unlike much of the industry, the Times Company, which publishes *The New York Times, The Boston Globe* and *The International Herald Tribune*, does not carry the kind of crushing debt that has led to other publications to default on holding on to revenue from ads and circulation. or file for bankruptcy,

"But the company reported last month that its newspaper ad revenue fell 14.2% in 2008, for a drop of 19.5% in the last two years; industry-wide, the declines were 16% and 23%.

"And unlike almost every other major paper in the country, the flagship *Times* newspaper has not significantly reduced the size of its newsroom or the content of its pages; its newsroom staff of almost 1,300 people and budget of almost $200 million are easily the largest in the country.

"And perhaps more so than any other newspapers, the *Times* has made a long-term bet on the digital future, integrating its print newsroom with the Web, adding blogs, vertical sites like Deal-Book and City Room, slide shows and videos, even taking on Wikipedia with its Times Topics. pages.

"The bet was that Internet ads would keep growing fast enough to eventually outweigh the erosion of ink-and-paper revenue. But the company's digital revenue has leveled off after years of torrid growth actually declined slightly in the fourth quarter – and it remains just 12% of all revenue. And no one is sure of the trajectory for either print or digital ads once the economy recovers.

"That puts a squeeze on cash flow. The Times has been trying to sell its stake in the Boston Red Sox and arranging a sale-leaseback of its new headquarters building.

"It slashed its stock dividend by almost three-quarters, and last month borrowed $250 million, with interest above 14%, from a Mexican billionaire, Carlos Slim Helu.

"Newspaper analysts say that despite some published alarms to the contrary. the company has positioned itself to ride out another year of recession, maybe two. The company still operates at a profit, and might have gotten by without the Slim loan, but could not afford the risk borrowing could be even harder in six months or a year.

"'But,' said Edward Atorino, an analyst at Benchmark, a research firm, 'I think they've put *The New York Times* out of danger.'

"One of the company's two revolving credit accounts will expire in May, with no realistic prospects of renewal, reducing its capacity for short-term borrowing to $400 million. The company already owes $380 on the two accounts, leaving little room for maneuver. It has a $99 million payment on longer-term debt due in November, and $250 million in March 2010."

Let me break off at this point to emphasize that what is at risk of non-survival is not only *The New York Times*, which happens to have a dedicated family devoted to its survival, but the institution of what is near-best in the field of print and possibly internet journalism. Since we are embarked on the problem of communication in general and economic in particular, we must envisage the hazards of survival of this unusual company standing at the cross-roads about the possibility of communication in our society.

This is why I have been seeking in sociology what economics as it is practiced today denies us with all doors slammed.

On the same Business Day page of the same issue of *The New York Times* ("Why Analysts Keep Telling Investors to Buy" by Jack Healy and Michael M. Grynbaum) we can read: "Even now, with the recession deepening and markets on edge, Wall St. analysts say it is a good time to buy.

"Still. At the top of the market, they urged investors to buy or hold onto stocks about 95% of the time. When stocks stumbled, they stayed optimistic. Even in November, when credit froze, the economy stalled, and financial markets tumbled to their lowest levels in a decade, analysts as a group rarely said sell.

"And last month, as the Dow and Standard & Poor's 500-stock index suffered their worst January ever, analysts put a sell rating on a mere 5.9 this time around, credit rating agencies, mortgage companies and Wall St. bankers have shouldered much of the blame for the Crash of 2008, and few have questioned publicly the analysts who urged investors to buy all the way down.

"Analysts completely missed the boat again with the subprime and credit crises,' said Jacob Zamansky, a securities lawyer who represents investors. 'They should have been given early warning signs to investors to bail out, or at least lighten up their portfolios. That warning never came.' Instead, many recommendations urged investors to hold on to their shares.

"On October 8, as Congress and the Treasury Department frantically tried to calm the plummeting markets, a Citigroup analyst upgraded Bank of America to buy. Since then Bank of America shares have fallen 77%.

"That same month. Jeffrey Harte, a top-rated analyst at Sandler O'Neill and Partners, also lifted Bank of America to buy, from hold, and a month later, he gave Citigroup the same upgrade, according to Bloomberg data.

"With every wrenching decline, stocks seemed to be only better and better bargains to the most bullish market watchers, and their buy ratings seemed to reflect a hope that the market would soon turn a corner.

"'The market went up, up, and up. You were rewarded for saying, "Don't worry, be happy,"' said William A. Fleckenstein, president of Fleckenstein Capital, a money management firm in Issaquah, Wash. 'Each time the market went down was a new opportunity to buy the stock even cheaper.'

"When the storms of last year hit, few investors realized that this pattern would suddenly vanish with disastrous results.

"In all of 2008, sells never outweighed the buys. Some attribute the surplus of optimism to a widespread expectation that stocks – like house prices – will always increase over time. After all, the S&P has posted annual returns of more than 9% during the last 80 years. Analysts did, not want

Continued on page 19

Clipping Off the Wings of America?

No one would question that these are daunting times. But these should be taken as a challenge to re-examine our history, and our economic and other literatures to see what we are missing – or indeed have allowed the power-overendowed in our society to suppress.

That is why the front-page story in *The New York Times* (1/02, "Reinvention or Recovery?" by David E. Sanger) does at least clear the way for a much-needed debate.

"Washington – As President Obama and Congress barrel toward the latest program to resuscitate the economy, one question is looming over their search: Can the government fashion a fast and efficient economic stimulus while also remaking America?"

This abstracts from exactly everything that has brought on the current crisis and is destroying the very image of America.

"For now, Mr. Obama and his aides are insisting they can accomplish both goals, following their mantra of using the urgency to accomplish larger reforms that never garnered sufficient votes in ordinary times.

"In fact, at various times in American history, moments like this have been used for big programs, from integrating the armed forces to creating social security and, later, Medicare. So it is little wonder that everyone with a big, stalled transformative project – green energy programs, broadband networks that reach into rural America, health insurance for the newly unemployed or uninsured – is citing the precedent of Franklin D. Roosevelt, and declaring that a New Deal is overdue.

"But the question that the Senate will begin debating Monday is whether grand ambitions are getting in the way of pulling the country out of a nose-dive. And so for every comparison of this moment to Roosevelt's first hundred days there are warnings that much of his social experimentation did not have a big impact on economic recovery."

The first thing that we must respect is history, for it is the source of the nation's ability to learn from past mistakes and successes, and those of the academic disciples most immediately and deeply involved – which in this case is economic theory. And it is in ignoring this maxim that Mr. Sanger is most at sea in a leaky boat.

For President F.D. Roosevelt's greatest achievement did indeed "have a great impact on America's economic recovery which took years." But within a few months of the bank moratorium that Roosevelt declared on being inaugurated to keep up with the thousands of banks that were shutting their doors, the *Glass-Steagall* legislation had been brought in. That barred the commercial banks from acquiring interests in the "other financial pillars" – to wit in that distant day, stock brokerages, insurance and mortgage companies. The reasoning was clear and powerful: each of these kept its own cash reserves needed for its own operations. Allow the banks access to these and they would take them over and use them as legal tender base for applying the "banking multiplier" – the multiple of their cash reserves that they can lend out in bank credit of their own creation. And it was by moving from one to another, there resulted financial skyscrapers with elevators that could only move up at ever greater speeds, never, ever down.

It was because *Glass-Steagall* was increas-

Children Parted from Parents in This United Walled World

The New York Times (14/02, "100,000 Parents of Citizens Were Deported Over 10 years" by Michael Falcone) tells this paradoxical tale of parents and their native American children separated as the parents are deported or accompanying them into deportation in ways that the founding fathers could hardly have imagined. It is another of the multiplying paradoxes of this globalized and ever more heartless world.

"Washington – Of nearly 2.2 million immigrants deported in the decade ended 2007, more than 100,000 were the parents of children who, having born in the US, were American citizens, according to a report issued Friday by the Department of Homeland Security.

"But the department lacks data that might have addressed questions left unanswered by the report, like the number of American children who were left behind in the US or, alternatively, exited the country with their deported parents. Nor could the report say in how many instances both parents of such children were deported."

The fact that it had not occurred to the Washington bureaucracy to even ask, let alone answer these questions, bespeaks an insensitivity in which a too globalized planet has too scant time and space for such concerns.

"Similarly, said Representative Jose E. Serrano, Democrat of New York, since no one knows how many children a given deportee had, the number of affected children could be much higher than 108,434, the exact number of the deported parents.

"So 'the problem goes deeper than just the numbers you see,' said Mr. Serrano, who requested the study. He called the circumstance 'tragic.' 'If they took their children back,' he said of the deportees, then technically we deported an American citizen. 'No matter which side of the immigration issue you fall on, there's something wrong with the notion of kicking American citizens out of their own country.'

"The Homeland Security Department's office of inspector general, which conducted the review, said it had ordered a look at the feasibility of tracking down more data about the deportations.

"Mr. Serrano, who represents a heavily Hispanic district in the Bronx, is vice chairman of the House Appropriations subcommittee that oversees spending on the department. He has introduced legislation that would allow immigration judges to take family status into account when deciding on deportations.

"Mark Krikorian, executive director of the Center for Immigration Studies, a policy institute in Washington that supports tighter controls on immigration, said immigrant parents of children born here should not receive special treatment.

"'Should these parents get off the hook just because their kids are put in a difficult position? Children often suffer because of the mistakes of their parents."

He might not realize that young, innocent human lives are at stake. When Washington imposed globalization on the world, it should have realized that, brought more closely together, would require a lot of human sensitivity rather than just more business for Wall Street.

W.K.

ingly disregarded and ultimately repealed and the age of derivative "risk-control" brought in that we ended up in this mess.

The *Times* article goes on to those who take issue with what President Obama has brought in, on the grounds that it is too extravagant, while others that it is not ambitious enough. What is missing is a real grasp of the history of the American economy and of the world.

For that the writer would have had to note the key importance of the nationalization of central banks throughout much of the world. Even in the United States, where the shareholders of the Federal Reserve remain the private banks who originally subscribed for its shares, for long periods looked after an increasing amount of the nation's capital financing, with a substantial part of the interest ending up with the federal government as the heir to the ancestral monarch's surrender of his monopoly in coining precious metals.

In Canada it is far simpler. Our government bought out 12,000 shareholders at a good profit in 1938 less than four years after they had acquired the stock. But nonetheless, in 1996, when the US banks had got into deep trouble in the US by taking over the Savings and Loan mortgage trusts, it was the American government that introduced serious accountancy – "accrual accountancy" the enters ever transaction in the ledgers twice – once the money invested which is "amortized" over the foreseeable period of usefulness of the investment made, but the asset value of the investment itself had been written off completely in the year in which it was made, and thereafter carried at a token one dollar.

If a private corporation used that sort of bookkeeping its executives would be fined or worse. The government got away with it for decades. However, by the late 1980s the American banks had got themselves into a peck of trouble by taking over the Savings and Loan – significantly, *mortgage* trusts – and to get them out of the their losses the Clinton government switched to "accrual accountancy" – which a Crusader Order is recorded to have brought back from Arab lands. That revealed more than $1 trillion of completely paid investments. That not only saved the banking system, but made possible a drop in interest rates that brought on the technocracy boom that continued to the late 1990s.

That provides us with a precedent for making use of a similar vast public investment of even greater amount that still goes unacknowledged. This would be enough to bail out what banks merit bailing out without burdening the nation with additional entirely unnecessary debt.

The precedent – the additional prepaid *physical* investment that had been treated as current spending by the federal government was finally recognized by bringing in of accrual accounting. This was completely

Survival *from page 17*

to hit the sell button just as the markets bottomed out."

But what was novel was the vast decontrol and deregulation of the banking system giving it access to the non-banking "financial pillars" (stock brokerages, insurance and mortgage companies) at the very time when derivative borrowed the mathematics of the atomic bomb to take care of risks. You might as well have declared the atomic bombs dropped on Hiroshima as a risk-eliminator, and the ignorance of what maths is about which has become the hallmark of economics courses has not helped.

This near hopeless situation pleads for a serious examination of what economics as currently taught are about.

And that is why we are searching the sociologists for helpful clues. Economics as currently conceived deprived of both a knowledge of pertinent history and mathematics, cannot fill the bill.

William Krehm

Some Stinging Statistics

To illustrate how the theocracy bubble works we quote from an article in *The New York Times* (27/01, "Data Show College Endowments Lost 23% in 5 months, worst Drop since '70s" by Katie Zezima): "The value of university endowments fell about 23% on average in the five months ended November 30, according to two recently released reports.

"The steep declines are forcing colleges and universities across the country to contemplate wage freezes, layoffs, and a halt to construction projects.

"'The drop found by the report is the biggest in the value of college and university endowments since the mid-1970s,' said John S. Griswold Jr., executive director of the Commonfund Institute which manages money for educational institutions and other non-profits.

"'It's been very sudden in some ways,' Mr. Griswold said. There were people predicting the decline a year ago or more, but I don't think anyone could claim to see the extent of this. The are unprecedented numbers.

"The reports, prepared by the Commonfund Institute and the national association of College and Universities Business Officers, drew on data from 796 institutions for the 2008 fiscal year, which ended June 30, and on additional statistics gleaned from a follow-up survey with 435 for the period from July 1 to November 30.

"They found that while endowments gained in value by about 0.5% in the old fiscal year, they lost nearly a quarter of their worth in the subsequent five months, a period in which the financial markets sank.

"'It's a rolling contagion that hit us,' Mr. Griswold said.

"The pain was spread among institutions large and small. private and public. When endowments were categorized by size, even the least affected – those worth more than $1 billion – were found to have lost an average of 20%. Those of $500 million to $1 billion – saw the biggest decline, about 25%. Public institutions lost an average of 24%, private institutions an average of 22%."

Obviously in the light of the Schultz Law resulting from the US government's forecasts and ultimate conclusion in Germany and Japan, the expenditures on education – particularly when our work-force needs employment and retraining in a crucial way. That must be considered not an expenditure adding to the budgetary deficit, but a prepaid investment in the capital value of the educated work force and the return from that investment are considered. Especially since the average expenditure on such retraining programs leads to capital gains as well. There is an acute and obvious need to sort out the accountancy of government investments in human capital, exactly as was done with physical investments by government in 1996 in the US and in 2002 in Canada. And, of course, passing on the investments in human capital by lower levels of government, and the whole, should it be needed, financed on an interest-free basis through the central bank.

Where the deficit lies is in the quality of our accountancy, not in the government's cash box.

W.K.

put in place by 1996 in the US, and in Canada more skimpily calculated after an open scrap on the matter between then Finance Minister Paul Martin and the then Auditor General, in 2002. The accountancy principle that had hidden these public physical investments from view was known as "cash accountancy" and has little to do with accountancy. It would bring a private corporation into hot water and might land a private taxpayer in jail.

Yet that still holds to hide a completely hidden investment of the US federal government in *human* capital. The principle involved is identical with the recognition as of the physical investments in the US in 1996. However, thereon hangs a special tale.

At the end of WWII Washington sent hundreds of economists to Germany and Japan to predict the time lag before those defeated powers could regain their prewar prowess as exporting nations. In 1961 one of these, Theodore Schultz of the University of Chicago published a study explaining how he and his colleagues missed the mark so badly in their forecast. "We had concentrated on the physical damage of the war, and overlooked that the workforces of the two defeated great powers had come through it basically intact." From this Schultz decided that the most productive investment a government can make is in its human capital.

There are special aspects to this. The children of educated parents tend to be more readily and better educated, quite apart from genetic influences.

If the US reached a figure for the worth of its physical investments of well over $1 trillion in 1996, its present unrecognized investment in human capital is hardly likely to be less than $3 trillion. England is still getting dividends on whatever it spent on the upbringing of Isaac Newton or Billy Shakespeare. $3 trillion dollars would be enough to fight the current economic meltdown by building more schools, hospitals, libraries, attending to the environment, lowering taxation.

The problem that stands between that negative-cost solution and society is that our history, let alone our economic lore, has been restructured and censored to serve those in power. That is where our quest must start. The problem is not figuring out the initial relationships, but political power. Who profit, and who see themselves and their privileges exposed by the our accountancy and our knowledge of history.

William Krehm

Correspondence

Your reminiscence of civil war in Spain was most interesting – chilling! It also suggests your age today being so long an eye witness to so much world history.

Perhaps you can shed some light on this bit of monetary history. I have long sought confirmation of an event I learned about in a 1950s radio program, *The Passing Parade*, in which John Nesbit told how Spain almost avoided the Great Depression. A banker had secured a new printing of Spanish currency from England where it was always printed for Spain. He forged the authorization and used the new money to make loans which revived the local economy and was spreading prosperity to the rest of Spain. When it was discovered that the money was not authorized it was declared counterfeit, the banker went to prison, and Spain relapsed back into the Great Depression.

Have you any information on this curious bit of monetary history?

On the present monetary crisis I have concluded that Keynes was on the right path but did not reach its destination. Deficit spending depends on a government spending borrowed money, interest paying debt. Keynes did not take the final step of recognizing that paper money need not be borrowed by governments which hold the sovereign right of seigniorage to print their own legal tender. Today there is no source from which to borrow the $100s of $trillions to redeem the outstanding innovative debt instruments Wall Street has created. Governments must abandon this myth that their legal tender must be borrowed at interest.

Governments must spend debt-free legal tender into circulation to finance the proper functions of government which sustain a civilized society and provide the legal tender to support private banking. It also eliminates the need for government to impose taxes. Taxes would be left for "inferior" governments to levy and only used to direct private business activity toward promoting the general Welfare, a basic function of government as stated in our US Constitution.

Your love of mathematics is well placed, it is the unambiguous language of science and engineering. Money created by interest paying debt, which is an asset to a bank and a liability to the debtor, must be continuously created by ever more debt in order to pay the interest on past debt. Elementary calculus shows that a quantity which increases at a rate proportional to its present quantity, increases exponentially with time! In the case of debt created money it exists only as long as interest is being paid on the debt. It vanishes when interest is no longer being paid. This is the main cause of the endless cycles of financial (economic) booms followed by busts (asset liquidation).

You understand this but our leaders, particularly academic economists, bankers, and the public don't! Our new financial system must be based on debt free legal tender upon which well regulated Fractional Reserve Banking may continue. Today's world wide collapse of the traditional banking, money creating system, makes possible the construction of such a new financial system. The alternative is a long, perhaps permanent, Great Depression.

Traditional bookkeeping must then be modified to account for government spending legal tender into circulation to fund its operation. This legal tender will be spent to build infrastructure both physical: rail roads, highways, schools and hospitals, and social: public health, education, security. Thus the financial books would show the legal tender spent is balanced by the number of educated, healthy citizens, produced and sustained: the number of miles of railroads, schools, and hospitals constructed and maintained. Thus government spending would be accounted as an asset with no liability.

I have long urged economists to abandon money in their work and use such physically measurable quantities in their calculations and computer models of GDP, etc.

The present California budget deficit of $42 billion in a 2009 budget of some $103 billion is literally incredible! In 1992 California finessed a temporary budget deficit by issuing warrants, IOUs. Suppose this time California not only issued warrants in payment of its expenses but also accepted, in turn, its warrants for payment of State taxes. California could encourage its citizens to use these warrants as money in commerce thus effectively printing money.

Regards,

Robert W. Zimmerer
Longmont, Colorado