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CONTENTS

Russia's Central Bank Murder Mystery

The murder in mid-September of Andrei Koslov, a top Russian Central Bank official, occasions some reflection on the diverse, changing functions of banks throughout the world.

As yet there is no futures market on human life in Russia. If you take your reading from the trend of the average life span, the figures are not impressive. It has shrunk shockingly since the end of the Soviet regime, The average life expectancy of Russian males today is 58 years, 16 years less than that in Western Europe. It is down from 65 years in the 1960s.

Since the intervening period witnessed decades of arms race with the US, and the privatizations since the fall of the Soviet regime, this drop coincided with some extremely drastic economic changes. American advisers retained for setting up the post-Soviet economic system succeeded in introducing an instantaneous "free market" like Nescafé. This had to be fictional because few if any of the essentials of a market system were at hand. An element of fiction, which in economic matters, is hardly compatible with morality, pervaded the system from its beginning.

Huge industrial complexes were first privatized, with shares handed out to all citizens. There were neither investors, nor many people around who knew what investing might be about; but there was an excess of ex-commissars and secret-service heavies who knew where the assets and the corpses were buried. Most of the citizens who received shares of enterprises had no other use for them than to buy to-morrow's breakfast. And a few shrewd individuals became multi-billionaires overnight.

The relationship between Man and Money has been the subject of much anthropological and economic research in recent years. That underlines the key importance of the Banking System which is the

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FOUNDING EDITOR
John Hotson 1930–1996
PUBLISHER–EDITOR
William Krehm
(comerpub@rogers.com)
CONTRIBUTORS Vol. 18, No. 10
Shirley Farlinger
William Hixson
William Krehm
Dix Sandbeck
Keith Wilde
CARTOONIST
Allen Good
INFORMATION SECRETARY
Herb Wiseman (herbwise@cogeco.ca)
WEBMASTER
John Riddell
Economic Reform (ER)
(ISSN 1187–080X) is published monthly by COMER Publications
245 Carlaw Avenue, Suite 107
Toronto, Ontario M4M 2S6 Canada
Tel: 416-466-2642, Fax: 416-466-5827
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COMER Publications
245 Carlaw Avenue, Suite 107
Toronto, ON M4M 2S6
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COMER Publications,
245 Carlaw Avenue, Suite 107
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Tony Koch (comer@pagecraft.org)
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Murder *continued from page 1*

creator of our money.

This provides a range of possible answers to the question "Who Killed Kozlov?" that would make a murder mystery writer's mouth water. He was a high, respected central bank official in Russia involved in cleaning up the accountancy and general morals of Russian banking. That means there were capital-shy and even corrupt banks that he had to shut down. There were thus depositors who – at least temporarily – that he separated from their deposits. Many will have believed in the continued existence of their deposits, but that could be simply faith, and there are penalties for impugning other folk's faith. He is reported to have enjoyed a good relationship with Mr. Putin. To translate the unusual rich energy and metal resources into wealth, as Putin needs banking facilities above reproach that clearly are not there.

There were Kozlov's celebrated good relations with foreign bankers who consider the corruption and lack of dependability of Russian bankers a serious hindrance to extending their activities to Russia. However, there have been no lack of Russians who for patriotic reasons consider that not necessarily a bad thing.

On the Variety of Bank Cultures

A few years ago we reviewed an anthology that appeared in Germany on the varieties of bank cultures.[1] The editor chose 12 countries to serve as examples of very distinct banking cultures. The very term "banking culture" rings a bell. For banks are entrusted with much of a nation's money creation, and credit distribution.

The Schuster book deals essentially with the banking cultures at a given time. Hawala Banking in South East Asia – developed in India and Pakistan – had as its determining trait the complete secrecy of transactions. This amounted to little more than money-changing at best, but could also involve a significant degree of money laundering. It lives on today mostly in the offshore banking havens. However in the celebrated case of the Bank of Commerce and Credit International that operated for decades before the Americans managed to have it shut down. But even the US permitted safe havens on US shores for improvisations like Eurodollars. These were expatriate US dollars created and remaining outside US jurisdictions and thus in practice not subject to the various US controls. The US government itself was thus providing the facilities for circumventing its own monetary restrictions. It was the exact equivalent, and in part possible a model, for the tremendous Hedge Fund gambling in conceptual oil and gas futures that has hogged the media headlines in recent days. The complex derivative gambles – especially in gas and oil – did not involve the actual commodities, but their abstract concepts, and yet they contributed to driving up the cost of a barrel of real crude perhaps by as much as $20, and collapsed with a gigantic losses to banks. There is no way of inserting morality into such an operation with a shoehorn. To make room for that luxury would need exchanging the current bank culture back to more primitive models.

In the book of Leo Schuster, the weakness of Argentine banking can be traced to its close association with the British economy which put it at the head of Latin American economic development prior to WWI. When Britain lost her position as one of the leading financial powers after WWII, the Argentine, that had been unofficially known as Britain's Sixth Dominion, felt orphaned and was perhaps a little too prone to seek a replacement of the good old British pound pre-1914 that had served it so well. It limited the issue of its currency to 100% US reserves. That proved a costly bit of reminiscing of long-gone happier days. Such has been he banking culture of the Argentine.

Mexican banking bears the mark of the importance of "buddy relationships" in the availability of bank credit. This *"cuate"* element is prominent in every phase of Mexican life. With precarious or tyrannical governments and clashing tribal memories still very much alive, security is sought in personal and family relationships.

We might extend this concept of banking cultures as changing in time as well as in space. For money goes far towards making the world go around, and money creation is the business of banks. It is a business that is the lair of many temptations and when the banking culture is allowed or even encouraged to change – often at times of bank bailouts by governments – drastic changes of bank culture occur. Many of the traits of Hawala bankers took over in Russian banks.

State enterprises, on the advice of American economists, were privatized, but there were no investors. It was not strictly Hawala banks that replaced the old state-owned institutions, but rather as though the gangster clients of the Asian Hawala banks took over. By attempting to cleanse the accountancy of the banks, Kozlov was trying to make possible deals with foreign banks. Not all patriotic Russian took kindly to that. Kozlov was apparently much appreciated by visiting foreign bankers – possibly for the noblest of reasons.

Whether Russian patriots would stoop to murder out of purely patriotic concerns, I have no basis for an opinion. The point is that there is a welter of bank cultures that have been set loose by the shift of power and the suddenly available oil billions. The power struggle mounts as there is more to fight over. And that is what Andrei Kozlov's demise at gun-point calls to mind.

The murder comes at an awkward time for the Putin government. For sitting on tremendous oil and gas revenues, Russia for the first time in its history is in a position to play the take-over game. But that calls for a banking culture that inspires trust, and the Russian banks have still a long way to go to achieve that. They could, indeed, be travelling in quite the opposite direction.

William Krehm

1. *Banking Cultures of the World*, edited by Leo Schuster, Fritz Knapp Verlag, Frankfurt-am-Rhein, 1996 [in German].

Post Script

But the rule of the gun in Russia is not confined to distinguished central bankers. A few days after the Kozlov assassination, came the news of the assassination of the BP unit's engineer in Russia,

We quote from *The Wall Street Journal's* account (BP unit's engineer in Russia shot dead" by Greg Walters): "Moscow – A top technician of an affiliate of BP PLC's Russian joint venture was found shot dead in Siberia over the weekend. The death comes two weeks after the killing of Russia's top banking regulator, Andrei Kozlov. "Russian news agency RIA-Novost reported Enver Ziganshin, chief engineer for Rusia Petroleum, was found by his wife in a sauna at his dacha around midnight Saturday. He had been shot three times, including once in the head.

Rusia Petroleum is majority owned by TNK-BP, a joint venture between BP and Russian investors.

Mr. Ziganshin's death comes amid tensions at Rusia Petroleum over its licence to produce natural gas at a large Siberian field, called Kovykta. Russian prosecutors threatened last week to revoke the company's licence for alleged failure to meet the production targets for local consumption set out in the agreement. TNK-BP says it is producing enough gas to meet local consumer demand, and the licence shouldn't be pulled. BP hasn't been able to fully develop the field because plans for exporting gas have been stalled. There is no evidence linking the death with the dispute over Kovykta. The circumstances surrounding the killing throw a fresh spotlight on the long-running Kovykta feud at a time when Russian officials are pressuring other foreign investors over their gas and oil holdings.

Officials threatened last month to revoke an environmental licence for Royal Dutch Shell project on Sakhalin Island. The threats have triggered warnings from Western governments that Moscow's heavy-handed tactics risk further eroding the country's investment climate for foreigners."

Thus strengthens the impression that Kozlov's murder was a more than a case of a banking culture, or the Zinganshin's death purely a matter of a bit of bargaining over the terms of gas and oil contract with foreigners arranged when the world oil and gas shortage was less acute. Along with an alumnus of the Soviet secret police as head

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Correspondence

Our friend and frequent contributor Robert W. Zimmerer of Longmont, Colorado, sends us a copy of his comment to PBS TV with Rep. Jim Cooper on August 25 which will prove helpful to readers wherever. We know no clearer, more comprehensive debunking of the "Pay off the Debt" nonsense that is on the lips of every penny or multi-billion dollar politician.

David Brancaccio, Host of *Now*
WNET
450 West 33rd Street
New York, NY 10001

Your interview about the terrors of the National Debt should have quoted John Maynard Keynes' famous observation about debt: "If you owe the Bank a thousand pounds you are in trouble. If you owe the Bank a million pounds the Bank is in trouble." This is the present status of international finance resulting from an enormous and growing US trade deficit financed by selling US Treasury bonds.

The Chinese and other big exporters sell merchandise to US citizens for $US most of which they return by purchasing US Treasury Bonds. The Japanese once bought Pebble Beach Golf Club, Rockefeller Center, and other trophy real estate as well as bonds.

The US occupies a unique financial status because its legal tender is de facto world money. Exporting nations allow the US to trade its Treasury Bonds for Goods and Services. What a deal! Should those Treasury Bonds ever be cashed, the world financial structure would collapse bringing disaster to all players, not just the USA. Imagine all those $US back into circulation!

Related to this is the necessity that growing global trade have ever more new money entering circulation. The US$ enters circulation through the purchase of our Treasury Bonds by the Federal Reserve Central Bank. This new legal tender plays the role gold once played when private banks lent out a multiple of their gold deposits in what is called Fractional Reserve Banking. Today legal tender, cash, actual paper dollars in circulation is balanced (backed) by our National Debt and bank loans are balanced by bank debt. As a consequence, if all bank loans were paid off there would be a severe reduction of money in circulation (to only cash) and if the National Debt were paid off there would be no cash to circulate either.

One can conclude that ever more legal tender which must be created should be issued directly by the US Treasury to fund the budget passed by Congress. There would be no phony National Debt created but rather new dams, highways, schools, hospitals, research laboratories, tuition payments to create a generation of well-educated citizens, and of course a universal health care system to maintain a healthy citizenry. New legal tender would thus be backed by human and physical assets not by paper. What I present here is nothing new, but another issue which gets no exposure by our establishment media for it threatens the profitable financial status quo. But PBS? How? Could they bring it into public awareness? I suggest a few resources which your research staff might get started? What a great TV series it would be!

Robert W. Zimmerer

The American Monetary Institute, Stephen Zarlenga: www.monetary.org.

The Committee on Monetary & Economic Reform, William Krehm: www.comer.org.

Economists Herman Daly and Joseph Stiglitz, both of whom served at the World Bank.

Doug Henwood: www.leftbusinessobserver.com.

Modern Money Mechanics published by Federal Reserve Board of Chicago: freedomcommittee.com/5534/freedom/books/mmm/mmm2.html.

The Bad and the Worse — A Study in Resurgent Neoconservatism

Orthodox economics – the main fare being taught in academia – is based on the view that laissez-faire markets under perfectly competitive situations constitute an ideal frame for economic activities. Accordingly, the efficiency of economic activities can be measured by how close to this ideal they are. With the stress on laissez-faire conditions, orthodox economics has become an integral part of modern neoconservatism since it delivers strong support to political views maintaining that the economy should be left free from government meddling. However, not lost on the political supporters, the free interplay among privately organized economic agents in laissez-faire markets is conveniently a mode of economic organization that serve the interests of the wealthy elite that the political right represents.

The great economic depression in the early thirties had brought Keynesian economics to the forefront. In the immediate after-war period, Keynesian economics was at its height and economists with a pragmatic view dominated the scene. Some of these economists, for instance, John Kenneth Galbraith, took their pragmatism to a point where they seldom in their works made references to the standard rigoristic economic models handed down from the neoclassical period. Others, for instance Tibor Scitovski, a Hungarian born American, used the traditional language and mathematics of standard economics, but by taking an empirical approach, came to reject the unquestioned efficiency of laissez-faire markets. In his classic work "Welfare and Competition," he demonstrates how markets in modern societies, where mass-produced products with often complex technical aspects dominates, make it impossible for the average consumer to be fully informed. That means that a principal condition of neoclassical economics, the assumption of rationality of all agents based on equal and complete information cannot be maintained. Instead, on the consumer's side markets become peopled by agents who are uninformed or not in possession of complete information.

Thus, the result is that firms, in their average position as price makers, will be able to force price-offer curves and price-consumption curves to meet at points on higher indifference curves that are more favourable to their interests.

The price-offer and price-consumption curve model is not exclusive to Scitovski (though it was a fairly new invention when he wrote this work) but can be found here and there in the general economic literature. But Scitovski uses it to show price behaviour in what he calls "restricted markets," which his book as a central theme maintains is the normal mode of competition in advanced economies.

The Question of the Contract Curve

Scitovski thus shows that the average outcome of market exchanges in markets in which price-making power is prevalent will not land on contract curve, but will create an inefficiently operating economy by forcing outcomes away from the fair exchange point on the contract curve. This contrast with what was shown happening in a simple exchange economy in which many outcomes also are away from the contract curve but stays within the social optima circle. In this case divergences from the contract curve were randomly distributed. However in a restricted economy, contract curve divergences are in a systemic way in favour of the price setting firms.

The neoclassical postulate, that laissez-faire markets will lead to outcomes distributed along the contract curve, are not empirically sustainable and therefore becomes academic questions (in a double sense, as these outcomes do not materialize except in the models diligently put forward in the universities' auditoriums). The reality is modern economies operating in restricted markets where average outcomes are off the contract curve and align along higher and more favourable indifference curves for firms.

But that only treats the problems of modern economies on one level. Another, and deeper question is whether or not we can take it for granted that the Paretian contract curve, if attainable, really would represent optimal outcomes. If an economy has a large aggregations of externalities affecting the utility of consumption acquired through market exchanges, the contract curve will only represent that part of utility that can be measured by money terms, and on the higher aggregated level in particular the valuation feed-back given by the financial markets, which as it is well-known mostly gauge short to medium valuations. If the economy's market sector creates a growing externality deficit there occurs a utility reduction, much of which also can be measured in money, albeit mostly in the longer term that the financial markets do not cover.

Long-term money valuation will always have an uncertainty factor rising exponentially with the time term. When social and environmentally concerned economists raise long-term aspects connected to long-term utility reductions that have been calculated into the economy's aggregate, it is customary by defenders of neoclassical economics to brush them aside as being normative, as they cannot not be calculated close to any accuracy; and therefore seen as unscientific exercises. This view that often is dictated by short term personal interests is not logical. That we for instance cannot accurately predict how many premature deaths bad air quality in urban centres will cause, say, twenty years from now, doesn't mean that we cannot verify a trend. In a similar vein, we don't know much about what effects climate change will cause – and some claim that it might actually also incur positive changes seen from the point of the Earth's ability to sustain man's livelihood. And that might very well be. Certainly, this far only some of the negative effects have been proven, such as ice melting causing rising water levels. If this trend goes on unchecked, it surely will in time inundate much low lying arable land and cities. The cost of averting that, when the ice melting process first gets truly underway, can only be extremely costly projects of either dike building or even large scale resettling people from flooded areas to higher land.

Neoconservatism and the Laissez-faire Revival

This means that to the extent that an economy has an externality deficit, the conception that the Paretian contract curve can represent optimal outcomes of market operations is not true. Not only does the existence of restricted markets make the theory empirically unverified, but on the basic theoretical level it is not factoring in the distortions that externality deficits cause.

After Friedman in the 1960s launched monetarism as a counterattack on the earlier Keynesian trend, pragmatist economists such as Galbraith (the latter especially abhorred by many of the traditionalist economists by spurning writing incomprehensible academic economic papers in favour of writing popular books about economics in a language that everybody could understand) and Scitovski fell into the background.

From the political side, Friedman's monetarism and other simplistic anti-government supply-side economic theories took the field. One well known instance is the Laffer Curve – predicting that when taxes rise, people will work less and therefore the government eventually end up raking in less money than before it jacked up taxes. This was just what the political leaders of the concurrently rising political trend of neoconservatism wanted to hear.

In particular, the "reverse" Laffer Curve predicting that when government lowers taxes they will eventually rake more in, as the lower taxes spurs people to work more, has been a main staple of modern neoconservative economic policies. What is never bad for its proponents, if the tax cuts don't work as predicted, they at least give the neoconservative political base of mainly high income groups more money in their offshore bank accounts.

Currently, Canada has in Harper a political leader who is an economist, holding a degree from the University of Calgary. Since he already during his university years was highly active in the then emerging trend of modern Canadian neoconservatism we may assume that economists of the Keynesian brand was not high on his reading list. Instead we probably can envisage Friedman's "Freedom to Choose" at his bedside. What is certain is that the vision of economic principles that is revealed in his approach to policies for Canada, much like the economic policies of George Bush, his kindred soul south of the border, is putting the interest of the established elite and corporate firms high on his agenda.

Paying the price are ordinary households struggling in average incomes brackets that not only are slow to rise, but also sure to bear the brunt of the effects that the lack of appropriate investments in environment protection and infrastructures will bring about. They are not the ones that can zip by in expensive toll lanes when the main road network becomes increasingly overburdened, a situation exacerbated by the missing development of other transport alternatives. And while air quality is deteriorating everywhere, it is less so in distant low-intensity developed suburbs for the well-heeled.

The Liberals were enormously harmful to Canada by the level of corruption and mismanagement that they allowed to develop on their watch. Not surprisingly, many voters have turned away from them. Under the Canadian winner-take-all election system the Harper neoconservatives are now in the driver's seat, with good prospects of exchanging their minority government with a majority one by capitalizing on the Liberals' sins and the system's inherent tendency to create vote-splitting that now, after the Alliance and the old Progressive Conservatives have merged, favours the right.

Thus for Canada the bad management of the Liberal government appears to have put Canada under a threat of being governed for a considerable time by a new Conservative party, with a neoconservative ideology akin to the current American rightwing Republican administration. Harper, the economist, promises that his government's policies will be guided by all the rigour that the fallacies of the laissez-faire market narrative comes with. Thus, all the mounting problems of a social and of an environmental nature that Canada currently faces, as well as the problem of a receding life quality in urban centres due to traffic overburden and smog, will not just be treated with indolence as under the Liberals, they will be pushed in the wrong direction by an ideologically possessed economist in the Prime Minister's office.

Dix Sandbeck

Mammoth Footprints Left on the Economy by Hedge Funds

There are certain things that cannot be buried or hidden from sight for very long. For example, contractors can't cheat on the cement in pouring the footings of a skyscraper, and expect what they have done to remain hidden forever.

Something similar applies to the logic of the self-balancing market in an economic system that has given us hedge funds that are driving the maldistribution of power between society and private speculative operators to the point of incoherence.

To track the source of so much inconsistency. we must go back to the ways in which our economic thinking is simply becoming *non compos*.

So let us put on our construction helmets and descend to the basement to see how the footings of our economy are holding up.

For at least two centuries there had been no lack of economic theories to help us understand the new economies that were sprouting. It is not difficult to detect where the position or the sympathies of the thinker lay – whether with the agrarian classes, or the traders, or the up-and-coming industrialists. But on one thing they were all clear enough – in their sense of what was greater and what was smaller. Their perfect record on that basic point was firm. That reassuring agreement came to a fairly abrupt close in the closing decades of the 19th century. The Paris Commune and much else had opened social cleavages in the new industrial society as never before, and a great need was felt to cover them up in the name of the very science that had sparked the social upheavals. The use of a bit of calculus – far beyond of the understanding of what passed as an educated person of the period – was impressive as well as intimidating. There was no understanding that mathematics is a means of processing the content of other disciplines, but not a sources of basic information about them.

And in this way the achievement of Isaac Newton and other in deducing the laws of gravitation from the movements of the planets of our solar system was taken as the economic model to prove that the market was of self-balancing by differential calculus. But to do this it was necessary to assume a "pure and perfect market" in which all actors in the economy were of such small power and dimension that nothing they did or failed to do could have the slightest effect on price or any other macroeconomic statistic. In effect this stood on their heads the basic concepts of big and small, the very foundation of arithmetic, and all other branches of mathematics.

However, these are used as war-paint rather than as a scientific tool.

And that is how the "self balancing market" model that confuses up and down, less and more, has given us the hedge funds in this age of Globalization and Deregulation which was supposed to bring on a world market completely deregulated – and hence, we were assured, completely self-balancing and rewarding to all its participants.

A Sample of a Supposedly Self-balancing Market

With this bit of background let us scan the latest news about the perplexity that the might of the hedge funds is causing throughout the world. *The Wall Street Journal* (27/07, "Worry Amid Hedge Fund Boom: Privileged Access to Information" by Henny Sender and Anita Raghavan) informs us: "In late 2002, the manager of Marshall Wace LLP, a large London hedge-fund firm, received two important phone calls from an investment bank that was about to unveil a client's offering of securities.

"Such offering would be of keen interest to investors. It could hurt the stock of the issuing company, French telecom giant Alcatel SA. That's because the securities could dilute existing shareholders' stakes.

"A call from an underwriter before an offering isn't a heads-up the average investor can expect to receive, *but hedge funds do.* The private investment pools control so much cash – some $1.2 trillion – and trade so heavily that they can account for up to one half of the daily activity on the New York and London stock exchanges. That makes them big sources of commissions for security firms. The firms, in turn, court the funds by feeding them steady streams of trading ideas and information about stocks, bonds and what other financial-market participants are up to."

The very size of hedge funds violates the "pure and perfect market requirement" on which the notion of "Deregulation and Globalization" and the self-balancing markets are based: "All agents so small that nothing they do or fail to do can in the least affect the market – i.e., the prices of a market assumed to be self-balancing. Note well: all the other conclusions sucked out of the assumptions of the pure and perfect market, notably that a free market leads to world peace in a society where democracy has been brought on by the aforesaid "self balancing market." And that, note well, has a bearing on everything that roils our contemporary world, not excluding Mr. Bush's effort to bring democracy his way to Afghanistan and Iraq.

Let us proceed with our *WSJ* quotation:

"For regulators, this constant flow of information stirs concerns about unfair advantages or what is worse, possible illegal trading. And in the Alcatel case, investigators for a French securities regulator have asserted that Marchall Wace ordered a sale of Alcatel shares about two minutes before the unveiling of the new securities offering. After the unveiling, the share price fell steeply.

RENEW TODAY!
(SEE PAGE 2)

"Marshall Wace and three other hedge-fund firms "used privileged information to make substantial capital gains with certainty," said France's Autorité des Marchés Financiers, known as the AMF, in a preliminary, unpublished report 19 months ago reviewed by *The Wall Street Journal*.

"Marshall Wace strongly denies that it traded on non-public information. It didn't sell until after the announcement of an Alcatel securities offering, Marshall Wace said, and a lawyer for the firm said this was known to the counterparties to the trades.

"There have been other recent probes, as well, of whether hedge funds have misused inside information. Britain's Financial Services Authority or FSA, has notified GLG, a star trader there, of plans to fine them as total of $2.61 million for alleged improper February 2003 trading in Sumtomo Mitsui Financial Group. GLG declined to comment. It is appealing the decision."

Why are bribes getting so common on the "self-balancing" market?

"Hector Sants, a managing director of FSA, has said in a speech last month, 'It may not be simply a question of considering whether hedge fund managers act inappropriately, but whether their models (including the high commissions they generate and their trading methodology) may create incentives for others to commit market abuse.' The reference is the huge size of the hedge-fund operations, which as part of the market, however, is deemed 'pure and perfect,' is assumed so tiny as to warrant the self-balancing market to be completely globalized and deregulated.

"The commissions the funds pay are disproportionately large because the funds magnify their bets with borrowed money and rapidly turn over their holdings. Security forms also provide various exotic investment products to the funds and lend them share to sell short when they want to bet against a stock. 'It's possible that hedge funds generate more than 50% of total revenue of the major brokerage houses,' says a report soon to be released by Greenwich Associates, a consulting firm in Greenwich, Conn.

"Regardless of the outcome of the trading in Alcatel shares, Marshall Wace's investment strategy illustrates the sort of symbiotic relationships between hedge funds and securities firms."

With Linked Digestive Tracts

It is as though their digestive tracts had become linked. Very little room for a "self-balancing pure and perfect market" there. And hence all the mathematical clap-trap that mistakes bigger for less can only mislead.

"Like other big funds, Marshall Wace received a steady flow of trading ideas from brokers that wanted its business. Mr. Wace hit on the idea of tracking how well the ideas panned out. Marshall Wace calls this strategy TOPS for Trade Optimized Portfolio System. (It was TIPS as first, but the firm feared that might sound suspicious, said one person at the firm.) The program draws 800 to 900 ideas a day in London, according to a Marshall Wace executive. TOPS elicited about 500,000 trading ideas last year from 246 securities firms, including 2,200 individuals at those firms.

"Alcatel shares, already declining for a few minutes before the bond announcement, slid still more afterward. They fell 1.6% in the final 16 minutes of trading in Paris after the announcement, the AMF report said. It added that Marshall Wace made a profit of about $672,000 on its trades. In all, the report said, the four hedge-fund firms made $2.6 million to $3.5 million on trades the report alleges were done using privileged information.

"As for Deutsche Bank, the bond underwriter whose employees called Mr. Wace before the offering, the AMF said, "This ongoing sanction case involves Deutsche Bank as well as various hedge funds." Although sounding out potential buyers before an offering is legitimate, the AMF report said Deutsche Bank had failed to 'observe the requirements about testing the market,' and said 'this investigation was made difficult by the uncooperative attitude of Deutsche Bank.'

"Some securities lawyers said that while Deutsche Bank's first call to Marshall Wace would have been a justifiable testing of the appetite for Alcatel bonds, the second one – just minutes before the announcement – would lack this purpose and thus could be problematic. Deutsche Bank failed to comment."

W.K.

A Certainty Carved in Stone Grows a Tail in the Form of a Question Mark

In this world – created by a benign deity but remade beyond recognition by megabankers – the one certainty has suddenly become unstuck. The more complex human affairs had become, the more absolute the prohibition to deal with them except through interest rates. Statesmanship became reduced to whether whatever sage at the head of the US Federal Reserve had decided to raise the benchmark interest rate 18 times for the 18th consecutive quarters, or grant the world a three-month surcease of wondering whether he would skip the 18th, and postpone bringing down a spindlelegged boom crashing on our heads a quarter or two later. But in the news columns of the financial press, the one blunt policy tool has begun appearing in an astounding variety of roles, more reminiscent of a TV star shifting from hero to villain, and from venerable nun to the world's favourite whorelet. A growing horror is appearing in the business press at the prospect of the Fed raising interest rates still higher when the world economy staggers under a record amount of debt.

China, the major challenger to the lone superpower role that Washington is clutching ever more precariously, is proving itself once again a virtuoso straddler of cultures. It has challenged Washington's "one blunt tool" for keeping the planet in its orbit: interest rates, no matter how high. The Federal Reserve and the economic faculties of a thousand universities seem to have forgotten that interest rates are the primary revenue and the favorite arm-breaker of loan sharks and speculative financiers. And to vest it with such monopoly powers, all alternative policies that had worked needed to be erased from human memory. That alternative had become the essence of central banking – the ability of the central bank to use the credit of the nation as legal tender and enlist private banks to use this money base – for lending out a multiple of the legal tender in their possession which it lent out to the public as near-money – distinguished from legal tender or "base money" by the government not lending it out but spending it into existence. As a result it earns no interest by its mere existence. That summed up the essence of central banking and banking, and that is why the system is known as "fractional reserve banking." Nothing, in short, that we or other monetary reformers invented.

The sole major alternative to higher interest for reining in a rising price level, that economists mistake for a sure sign that there is too much demand and not enough supply, used to be adjusting the "statutory reserves." These amounted to the commercial banks redepositing with the central banks a modest proportion of the deposits they took in from the public. In the case of chequing accounts, this usually varied between 8% and 12%. In the case of term accounts, where notice had to be given to withdraw a deposit, it was usually far lower. By moving this proportion up or down – rather than the benchmark interest rate – the central bank could raise or lower the leverage available to the banks in the credit (or "near-money") they could create on a given monetary reserve that they held. That proportion was also known as "the banking multiplier," and that was the system until its phasing-out in Canada in 1991-3, and its reduction to practical meaninglessness in the US and Britain.

The statutory reserves deposited by the commercial banks with the central banks earned no interest. There were several good reasons for that. The most important was that it would decrease the leverage of the statutory reserves in controlling the banks' creation of credit. And to have the same effect in cooling an overheated economy or stimulating a depressed one, the banks would have to increase or lower these reserve to a greater degree. The statutory reserves when they existed intact imparted a greater stability to the value of our currency than it would have if it were interest-bearing. For in that case it would reflect inversely every movement of interest rates. For it is the smaller net profit produced by raising these reserves to cool an overheated economy that counted. Banks were obliged to redeposit with the central bank on a non-interest basis a modest portion of the deposits it took in from the public. This provided an alternative to interest rates for influencing the pace of the economy – cooling it if were overheated – and expanding beyond the human and physic resources to do so, and stimulating it if too many of such resources were idle.

But obviously that major alternative interfered with the monopoly of the financial sector that it in the early 1990s actually achieved. This had produced a power shift from the elected government, and the old political coalitions in power – that notably included the industrialists and even in a minor way even the trade unions in opposition to the financial sector. High interest rates not only create unemployment, but attract footloose capital from abroad and drive up the value of the country's currency. And since Globalization and Deregulation had taken over, the total effects have devastated many lands.

Beijing Uses Reserves to Rein In the Municipalities' Splurge

Now let us turn to *The Wall Street Journal* (15/09) and in that single issue we will find not one but several articles notable for mentioning alternatives to high interest rates for fighting inflation.

Firstly there is the front-page spread "Booming Municipalities Defy China's Effort to Cool Economy" by Andrew Browne: "Mayor Zhao Jiancal says his vision is to transform backward Zhenzhou into the 'Chicago of the East' – a gateway between the booming coast and the vast interior – by more than tripling the city's size. Total investment in the area around the business district could hit $35 billion. It is a huge amount for the capital of Henan province, one of China's poorest.

"A similar dynamic is at work across China. Local governments are encouraging a frenzy of construction to boost their economies even as China's central government seeks to throttle back investment that is producing runaway growth. The economy expanded 11.3% in the second quarter of this year from the same period a year earlier, far outstripping the government's target of 8% for the whole year.

"Concerns are mounting that the boom could produce property bubbles that weigh down banks with bad debts when they burst. It could also clog railway lines and ports and trigger brown-outs as overloaded power grids collapse. Already, it is generating outsized demand for energy and raw materials, pushing up the cost around the world.

"Leaders cannot even be sure how much municipalities are spending, because local finances have become so murky. According to official figures that many economists believe understate the true total, fixed-asset investment rose 21.5% in August from a year earlier. The total value of all goods and services produced as a nation is much higher than Japan, South Korea or Taiwan produced even during their giddy years. If inflation takes hold, as some economists expect, the effects could would be felt globally. China is the world's third largest trading nation. Politically, the Communist central government maintains a tight grip over the entire country; economically, it is losing control.

"China's leaders are caught in a trap as they cast around for ways to rein in investment. The old administrative method – ordering state banks to stop lending, restricting land sales, halting government approvals for major projects – aren't working as well as before, partly because local governments are defying Beijing. Beijing has resorted to using satellite images to spot bulldozers working on illegal construction projects in far-flung provinces.

"Market-oriented measures to slow economic growth such as raising interest rates, aren't likely to be as effective in China as in more sophisticated economies. One reason is that local bankers are still susceptible to political pressures to extend loans. Also state-run companies make a habit of not repaying loans, so the cost of funds is irrelevant. Much of the corporate investment is funded out of company savings."

Caught in a Trap

"'It's mindless,' says Wang Lia, a researcher at the Chinese Academy of Social Sciences, a leading think tank, who says local governments are generating large amounts of wasteful investment. About 10 to 20% of all investment is made by local governments, according to World Bank economist Louis Kuijs, based in Beijing. Under China's former socialist economy, central planners in Beijing doled out investment funds under an annual quota program – so much for the railroads, for the power industry, for steel-makers. China's central government grabbed local revenue and redistributed the cash around to pay for further investment as well as for government services.

"That started changing in 1978, when Den Xiaoping launched economic overhauls that made local governments responsible for delivering growth to their communities. Economic growth became the path to career glory for mayors, who are now driving the economy to a considerable extent.

"There are good reasons why China's cities need to expand. Each year they have to accommodate at least 10 million peasants flooding in from the countryside. Increasingly, cities also have been forced to fund their

CAP Motion re: Dollarization in a North American Union vs. National Monetary Sovereignty

WHEREAS:

1. There exists an unconstitutional restructuring of Canada, the USA and Mexico into the formation of a super-NAFTA, super regional political and economic entity driven by the agenda of the financial/industrial corporate elite of North America.

2. The Presidents of the USA and Mexico and the Liberal Prime Minister of Canada (Paul Martin) signed an agreement in March of 2005 called *"The Security and Prosperity Partnership Agreement"* which promised to implement and effect that elite agenda.

3. The three national leaders met again in March of 2006 (Conservative Prime Minister Harper) reporting to each other on the progress of their countries' respective implementation progress.

4. This North American Union entity is eliminating the sovereignty of the people.

5. This restructuring is occurring bureaucratically outside of the Parliamentary process.

6. The changes go before Parliament piecemeal and incrementally, and then are rubberstamped.

7. Such restructuring exceeds the power and authority of the executive branch of government.

8. Such restructuring violates the constitutional rights and protections of the citizens of the respective nations, as those constitutional rights belong to the citizens of each country, not to the corporate elite, nor national leaders, nor to the governments.

9. The USA's Council on Foreign Relations produced a report in 2001 called *"Building a North American Union."*

10. Among other things, that report called for the creation of a new currency called the "AMERO," a currency proposed to replace the US dollar, the Canadian dollar, and the Mexican Peso.

11. Other proposals call for the adoption in North America of the US dollar, i.e., the dollarization of Canadian and Mexican currency presumably governed by the US Federal Reserve, a collection of powerful US private banks.

12. There is no greater aspect of sovereignty than the currency of a country.

13. An independent currency empowers a nation to protect its national interest as and when necessary. (This was proven in Mexico and the Argentine when scholars reached the conclusion that governments that did not make their currency dependent on the US dollar fared far better than those who did.)

14. A common currency of Canada and Mexico with the USA would be a subordination of Canadian and Mexican currency to that of the United States, as happened catastrophically in Mexico in 1995 and in the Argentine around 2000.

15. At the beginning of the millennium, the Argentine had been persuaded to have every peso backed by American currency before it could be issued. Thereafter Argentine descended rapidly from the most developed Latin American country to one of third nation status.

16. In 1995, after Mexico issued its debt payable either in US dollars or in the Mexican peso at the holder's choice, and after NAFTA caused the abolition of all restrictions on the movement on short term money across the frontier, the Mexican peso lost 40% of its value, and the Mexican standard of living tumbled to the worst level in generations.

17. The idea of the adoption of a US currency for Canada has been raised and dismissed before in Canada, but the corporate financial elite refuse to take "no" for an answer.

THEREFORE:

1. CAP/PAC calls for the continuance of an independent sovereign Canadian monetary system rooted in the utilization of the Bank of Canada, and rejects any suggestion of a "common currency" with any other country, or the US dollarization of Canada's money supply.❧

own health, education and social welfare.

"The resulting revenue isn't part of the regular budgets that can be audited by Beijing.

"If Shanghai were a country, it would be among the 40 largest economies in the world. Its economic output last year of $114 billion was bigger than that of the Philippines or the Czech Republic. Shanghai led the way from the early 1990s by setting out to build a national financial and commercial hub in an area called Pudong. It is now building a series of satellite cities – each themed after a certain country – to relieve pressure on the city centre.

"To acquire more land that they can sell, cities simply redraw their boundaries to engulf the surrounding farms. The compensation they pay the farmers for the land is far less than its value to the developers they sell it to.

"In March, Premier Wen Jiaban unveiled a five-year economic blueprint to steer China in a new direction. Instead of going-for-broke growth that has blighted the environment and widened social divisions, China would pursue more balanced development. Still, growth is running at its fastest pace in 12 years."

Now comes the sensational paragraph: "China's leaders *have taken funds out of the banking system by raising reserve requirements – money that commercial banks must deposit with the central bank rather than lend out* – and slapped new taxes on real estate transactions.

This is the third reference in the Western press to China's adoption of statutory reserves – an alternative to raising benchmark interest rates further to curb financial growth. In the first report in the *WSJ* the American writer clearly hadn't a clue of what was involved – so utterly has information of the function of the statutory reserves been suppressed as an alternative to higher interest rates for restraining growth. This was the third successive reference in the *WSJ* to the innovation in China; of what has not only been abandoned in the US – the use of the statutory reserves to cool the economy. But there has been no reference to the role that statutory played during over a half century before they were wholly suppressed.

Even now the tremendous strategic significance for China of the device is not realized. This technique pioneered in the *Bank Act* under Roosevelt in the depth of the Depression in 1935 serves China's present purposes in at least a triple sense:

1. It restricts economic growth beyond the current availability of resources. And, of course, it is less destructive than higher interest rates because it can prevent the es-

CAP Motion on Statutory Reserves

WHEREAS:

1. A central bank (in our case the Bank of Canada) properly used in the sovereign best interest of a nation's citizens requires the use of statutory reserves.

2. Statutory Reserves are an alternative to interest rates for controlling the economy.

3. Interest rates hit everything in the economy, and especially hurt the unemployed.

4. Statutory reserves, properly used, permit the exercise of the financial sovereignty in defence of society's interest at minimum costs.

5. Statutory reserves give the government the use of interest-free money.

6. Statutory reserves are an essential means of financing essential infrastructure for a modern society.

7. The statutory reserve is the requirement that banks deposit with the Bank of Canada a percentage of the deposits they received from the public. These statutory deposits do not earn the chartered banks any interest (i.e., the BoC does not pay out any interest to the chartered banks on this reserve). The percentage rate of the reserve requirement can vary determined by an overheated economy.

8. The purpose and effect of statutory reserves is to decrease the amount of leverage of money creation by the private banks in the given cash base (that is, the number of times the bank can lend out the same dollar). This provided the means of cooling off an overheated economy or stimulating a depressed economy without changing interest rates.

9. Statutory reserves were the basis of the most prosperous and productive quarter century in Canada's history following WWII. (During this time Canada renewed and modernized her infrastructure neglected during 10 years of depression and 6 years of war, introduced new technologies, assimilated and integrated large numbers of refugees into a higher and productive standard of living, etc.)

10. The existence of statutory reserves was responsible for keeping interest rates low.

11. The Bank of Canada was founded in 1935 under a Conservative government regime and was nationalized in 1938 under the Liberal government regime of William Lyon MacKenzie King by the purchase of 1200 private shares at a fair price.

12. Statutory Reserves were then and still are now an essential component of a sovereign banking system functioning in the best interest of the people of a nation.

13. Following the nationalization of the Bank of Canada, the percentage of the federal debt ratio to the GDP fell from 160% to 26%. The current proportion of the federal Canadian debt to the GDP is 73.1%.

14. Statutory Reserves in Canada followed the model established by President Roosevelt in the USA in 1935, in the USA's *Bank Act* of 1935.

15. The Statutory reserves were eliminated in Canada by the Mulroney Conservative government over two years beginning in 1991. Subsection (4) of Section 457 of Chapter 46 of the *Statutes of Canada 1991* change the *Bank Act* to provide for the phasing out changes in the *Bank Act* respecting the requirement of our chartered banks to maintain reserves with the Bank of Canada (*Meltdown*, William Krehm, p. 116).

16. Since the statutory reserves were eliminated, the percentage of the federal debt ratio to the GDP has escalated at incredible rates. (Chartered banks built up their holdings of government bonds which no longer required cash reserves at the central bank nor more capital of their own. Between December 1990 and August 1994 their portfolios of federal government bonds soared from $3.5 billion to $35.6 billion – i.e., by 900%. The total federal debt held by the banks increased by 300% to $80 billion. See *Meltdown*, William Krehm, p. 153.)

THEREFORE:

1. The Canadian Action Party will resurrect the use of statutory reserves at a percentage level to be based on a revised sanitized price index that would effectively deal with the rate of inflation, and to begin with the range of the reserves to be set at about 8% to 10%.❧

tablishment of a financial autocracy.

2. Raising the benchmark interest rate would push up the exchange value of the yuan which is exactly what Washington has been urging on Beijing. That would brake its exports which are vital to China to provide employment for its huge mobile surplus population.

3. Though this is not made clear in the reports, the statutory reserves – if they are non-interest-bearing – place legal tender in the hands of the government within the restraints in force, and remove it from the banks funding the municipalities in their extravagant projects.

Though the US Security establishment and the President himself have never even referred to the point, it does nothing for the relations of the Western powers with Islam that the former should have proclaimed higher interest – that Allah punishes with eternal hell-fire – as the sole blunt tool for keeping the world safe for democracy. We are still awaiting the first peep from Western governments towards allaying this serious clash in economic morality between the Washington Consensus and Islam.

Unfortunately in several European countries, interest is paid by the central bank in which they are deposited. Joseph Stiglitz – in some respects an effective critic of the deregulation of the world banking system – even refers to this as "bank seigniorage." However, the expression hides the purpose of such statutory reserves. When the government receives the free use of such funds this is a continuation of allowing the ancestral monarch's monopoly in coining precious metal into legal tender. When banks in Canada were first allowed to issue paper bills before the founding of the central bank in 1935, they deposited the cash equivalent of the bills that they issued with the Finance Ministry. There is no historical precedent that would warrant their free ability to issue circulating medium without some compensation to the state. It was in fact the bailout of the banks from their speculative losses that was first made possible by money taken from the public treasury on an ongoing basis. Our banks have been more profligate with public money than any baroque monarch.

In the regroupment of the major economic powers, China's use of statutory reserves can become an enormous advantage over its world rivals. Should we not be keeping up with them and return to fractional reserve banking that was developed in the West?

William Krehm

Washington is Using the Wrong Chemistry in Afghanistan

In *The Globe and Mail* (10/9) John Polanyi, Nobel Laureate and member of the Chemistry Department at the University of Toronto explains the disturbing comeback of the Taliban in Afghanistan.

Referring to our Prime Minister's understatement at the UN General Assembly "We cannot afford to fail," he puts the finger on the "poppy-eradication program that is alienating the population. It is the wrong policy, given the global shortage of essential pain-killers obtained from opium." If properly regulated, the poppy crops that the "liberators" are destroying could provide a legal source of income to impoverished farmers, while depriving the drug lords and the Taliban of revenue.

"The argument has been made by the Senlis Council, a think-tank with offices in London, Paris and Kabul. The illegal drug trade, estimated by the UN at $2.7 billion per year – more than one-third of Afghanistan's GDP – threatens to drive the country from a narco-economy to a narco-state.

"By 2010, the World Health Organization estimates there will be 10 million cancer cases a year in the developing countries, in addition to the millions of cases of HIV/AIDS. The WHO describes the expected demand for opium-based medicines as a 'world pain crisis.'

"The International Narcotics Control Board, which licences traffic in morphine and codeine, points out that the richest nations consume nearly all the world's opiates, leaving 80% of the globe's population virtually without. Could opiates made from Afghan poppies cover the shortfall, if the INCB were to licence growing there, as it does in France, India and Turkey? Maya Scalavitz, a senior fellow of Stats, a media watchdog group, has estimated the cost of buying the entire Afghan poppy crop at about $600 million. That is less than the $780 million the US budgeted last year for eradication.

Surely P.M. Stephen Harper would have been better advised to pick up and make that point instead of the servile clap-trap echoing the US rhetoric. It would have helped stop coffins of Canadian young men coming home from Afghanistan.

On the same day rightist *New York Times* columnist John Tierney not only covered the ground on Afghanistan poppies, but went on to describe the exactly parallel situation with Andean coca leaves in South America. "In the Andes, American drug policies made Bolivians so mad that they elected Ivo Morales.

"At the UN, Morales denounced the 'colonization of the Andean people.' It has been demonstrated that the coca leaf does no harm to human health,' he said, a statement much closer to the truth than Washington's take on the leaves. The white powder sold on the streets of the US is dangerous because its such a concentrated form of cocaine.

"South Americans routinely drink coca tea and chew coca leaves. The mild amount of cocaine in the leaves is a mild stimulant and appetite suppressant that isn't more frightening than coffee or colas. When the World Health Organization asked scientists to investigate coca in the 1990s, they said it doesn't seem to cause health problems and might yield health benefits.

"But American officials fought against the publication of the report and against the loosening of restrictions on coca product,. The American policy is to keep attacking the crops, even if that does impoverish the peasants; or, more typically, turns them into criminals.

"Drug suppression in Bolivia and Afghanistan has done exactly what alcohol prohibition did in America: it has financed organized crime.

"President Morales is right to complain about American imperialists criminalizing a substance that has been used in the Andes for centuries. If gringos are abusing a product made from coca leaves, that's a problem for the US to deal with at home. The most cost-effective way is through drug treatment, rather than cutting off supply. 'America makes plenty of things that are bad for foreigners' health – fatty Big Macs, sugary Cokes, deadly Marlboros – but we'd never let foreigners tell us what to make and not make. The Saudis can fight alcoholism by forbidding the sale of Jack Daniels, but we would think they were crazy if they ordered us to eradicate fields of barley in Tennessee.'"

However, should we begin thinking along such lines, there is a real danger that World Peace would break out. And that might be bad for GDP.

W.K.

The Town of Lakeshore Takes the Lead — Others Must Follow

We have received the following most important communications from Lakeshore:

Town of Lakeshore
Belle River ON N0R 1A0

August 23, 2000

A.M.O.
393 University Ave., Suite 1701
Toronto, ON M5G 1E6

Dear Sir or Madam,

Re: Bank of Canada Borrowing

Please be advised that Lakeshore Council at its regular meeting of June 12, 2006, a delegation presented information to Council regarding borrowing funds from the Bank of Canada which resulted in Council requesting an administrative report. At its regular Council meeting of August 22, 2006 Council received the administrative report subsequent to which the following resolution was adopted:

Councillor Janisse moved and Councillor Sylvester seconded:

That

1. Council receive this report regarding borrowing from the Bank of Canada for information.

2. Council forward a copy of this report and resolution to the Association of Municipalities of Ontario (AMO) and the Federation of Municipalities (FCM) for their comment and action, if appropriate.

Motion Carried

You will find attached a copy of the report prepared by our Director of Finance and Performance Services. Should you require any further information with respect to the above please feel free to contact the undersigned. I remain

Yours truly,

Mary Masse, AMCT, Clerk
cc: Federation of Canadian Municipalities
Mr. Andre Marentette

Town of Lakeshore
Finance and Performance Services

To: Mayor and Members of Council

From: Sylvia Rammelaere, CA, Director of Finance and Performance Services

Subject: Bank of Canada Borrowing

It is recommended that:

1. Council receive this report and resolution to the Association of Municipalities of Ontario (AMO) and the Federation of Municipalities (FCM) for their comment and action, if appropriate.

Comments:

In order for any municipality to borrow from the Bank of Canada, under the *Bank of Canada Act*, section 18(c), it must be guaranteed by the federal or provincial government. The response to our enquiry, by way of a phone call to the Bank of Canada in Ottawa, was that they do not lend funds to a municipality. This same presentation to Council was made in 2004. Attached is a copy to the letter forwarded to the Province, as well as their reply. The Minister of Finance indicated that if low or no interest loans were made, inflation would eventually increase. Another consideration is that the municipality would have to have a credit rating, which we do not. To get a credit rating would incur some costs as well as staff time. This would have to be done on an annual basis If the Provincial or Federal government does agree to guarantee for Lakeshore, they would have to do so for all municipalities, which they may not be prepared to do.

Given the nature of the request, administration is of the opinion that AMO and/or FCM should be pursuing this on behalf of all municipalities. If something like this were possible, it would have a better chance of success coming from the municipal organizations rather than from a small municipality.

Others Consulted:

The senior management team was consulted and is in agreement with the recommendation.

Attachments:

Appendix A: Letter to Paul Martin, June 11,2004. Appendix B: Letter from Minister of Finance, August 16, 2004

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In our next edition we shall carry the correspondence of mentioned above, along with our comments. On the incredibly misleading replies of the high officials who wrote them.

The Lakeshore Council is to be applauded for having kicked off the opening shot in what must become an organized discussion between the ever more seriously strapped municipalities and the central government. Meanwhile the newspapers in the sentencing of the Enron high executives are full of the extent to which Canadian banks used federal moneys that went to bail them out from their capital losses of the 1980s in a new career – opened to them by their further deregulation, to actually plan scams that one of them – CIBC has already settled with Enron to the tune of $2.4 billion US out of court while alongside two other Canadian banks it is awaiting trials for alleged misdeeds connected with the Enron scandals. It was in order to bail these banks out of their losses that our federal government slashed grants to the provinces, that passed on that same treatment to the municipalities. That is the main cause of their present plight. *The Globe and Mail* (28/09) carries an article "Banks Play down Fastow remarks" by Garry Norris, from which we quote" Royal Bank of Canada and TD Bank reacted cautiously on being mentioned by Enron's former chief financial officer before he was taken away to prison.... Investors suits have so far reached close to $8 billion arising from various Enron-related legal actions, notably $2.4 billion US in a settlement [out of court] last year with Canadian Imperial Bank of Commerce. While the Royal Bank of Canada is fighting the shareholder lawsuit it paid $49 million in July 2005, in a settlement with Enron itself which said "the RBC played the smallest of any of the financial institutions involved in the case."

By the time all suits connected with Enron have been settled – above all with the downturn of the economy and the further foreign losses of our deregulated banks coming home – it will be time for another bailout of our banks. That is why the municipalities that have always been left holding the ball must relate their hardship in meeting infrastructure, and social problems and ask: "Where did the grants slashed by the feds to the province, who passed on the compliment to the municipalities go? If the municipal organizations evade making the connection, democracy must be renewed within the municipal organization. There is no other way of preserving Canada for its citizens.❧

Global Economics and the HIV/AIDS Crisis

This year, 25 years after AIDS was discovered, 3 million people will die of AIDS and 4 million will become infected. Because Africa is the centre of this crisis at the moment there is a tendency to regard this as an African problem, but it is a problem involving many factors and Canada is not an innocent bystander. The global AIDS conference in Toronto and the first meeting of 30 Grannies-to-Grannies groups from Africa and 40 such groups in Canada gave rise to this analysis.

Acquired immunodeficiency syndrome (AIDS) is a set of symptoms that indicate a person has become infected with a virus that has seriously damaged the body's immunity system. HIV stands for human immunodeficiency virus. A key symptom is the development of one or more of a range of 'opportunistic' diseases from pneumonia to skin and digestive disorders. People can only become infected if their blood comes in contact with the HIV, Most people get it in one of three ways: having unprotected sex with an infected person: or being born to a mother already infected; injecting drugs with a needles that has been used by an infected person. New drugs called "antiretrovirals (ARVs) have enabled many people, especially in Canada, to control the virus and live more-or=less normal lives. However, there are numerous side effects of ARVs and the remedies can be complicated and costly.[1]

The immediate imperative for African countries dealing with the pandemic: (1) make AIDS drugs available to all; (2) end the stigma of people living with AIDS; (3) free up enough funds; (4) promote peace; (5) reduce poverty; (6) support education; (7) empower women.

1. Make AIDS drugs available. Most countries in Africa do not have a strong public health system to provide the necessary drugs and medical professionals. This is partly the result of the policies of the International Monetary Fund and the World Bank. These organizations, set up in 1944 to respond to the needs of the people of Europe after WWII, have since imposed policies called structural adjustment programs (SAPs).[2,3] These are described as: "eliminating restrictions on foreign imports, foreign ownership, cross-border financial flows, the export of natural resources, and the activities of foreign financial houses so that global corporations can move goods and money across their border at will; privatizing public assets and services including communications, power, and water by offering them for sale to private investors at bargain prices; slashing public expenditures for health and education to free funds for the repayment of foreign loans; and providing special tax breaks to private investors at bargain prices."[4]

Not only are countries borrowing money from the WB and IMF bound to these policies but there are few other lenders financial institutions willing to lend money except under such rules. After borrowing money and paying various interest rates over many years, ways needed to be found for repayment. The SAPS were intended for this effect. But countries have had to cut back on health, education, downsize government, privatize national enterprises, often for low prices, and prevent the formation of unions which would demand higher wages. These policies have affected governments' ability to help the AIDS population. A few of the Highly Indebted Countries have had their debts cancelled, but most are still paying interest on the unrepayable loans. I say "unrepayable" Because many of Africa's 54 countries cannot earn enough income from their exports to repay the interest, let alone the capital of their debt. African exporters are in stiff competition with one another so the prices they receive are low. In addition rich countries are refusing to lower the subsidies, tariffs and other barriers to tr4ade they impose as they continue to subsidize their own farmers and to provide free irrigation.

2. End the stigma of people living with AIDS. AIDS was first identified in Uganda in 1982. The local people initially believed the new disease was caused by witchcraft. Yet Uganda in 1992 was the first African country to announce a fall in the HIV infection rate. This was sometimes done by AIDS victims themselves educating others by singing, dancing, and acting out dramas in villages.

A good public education system, which does not charge for uniforms and books and can education the children, especially the girls, is important. In Canada AIDS victims have also known discrimination. This is partly because the first victims were homosexuals. Now there is greater acceptance. In Africa the victims are not mainly homosexuals, but still face discrimination.

3. Free up the Funds. The establishment of the Stephen Lewis Foundation will add to the initiatives/ Private donations from large donors such as the Melinda and Bill Gates Foundation will also help. The Grannies-to-Grannies organizations will raise funds to be sent to the Stephen Lewis Foundation. The aid will be targeted to those most in need, especially to women.

Governments can also help. However governments must be careful not to hinder progress in ways outlined in this paper.

When you enquire about the reasons for Africa not being able to provide the necessary funding to address the AIDS crisis, you get a picture of a continent plundered for hundreds of years until today. Africa is rich in gold, diamonds, oil agricultural products and people. Canada must take greater action on the conduct of Canadian corporations operating in Africa. If they had been given a just portion of the riches other countries have removed from Africa it would probably be a rich continent today.

Canada must take greater action on the conduct of Canadian corporations operating in Africa to give Africans a fair share of the profits and to make sure the corporations clean up after themselves,

Controlling your own markets has been labelled "protectionism." Some economists are now arguing that developing countries would be better off protecting their domestic markets than pursuing trade liberalization under the existing framework.

When companies are insolvent they can declare bankruptcy, pay a portion of their debts and start again. No such arrangement has been made for countries even when repayment is obviously impossible.

The privatization of water in South Africa is one example of globalization gone wrong. How are the poor to pay for water?

One policy that seems to benefit the poor is microcredit. There are many such schemes that lend small sums to people on condition that the money is repaid out of profits and returned to the system.

4. Promote Peace.

5. Reduce Poverty. With the majority of Africans surviving on one or two dollars a day it is not surprise that poverty is a major factor in the AIDS crisis. Women are sometimes driven into prostitution and this spreads AIDS. Large families have mean the splitting up of farms into smaller tracts and the exodus of children to the city. Urbanization has increased as people search for jobs no longer available in the country. This has led to an increase of AIDS in the cities and the transfer of the disease when husbands return home. Population is also driven by the fact that few African countries can afford Old Age Security pensions and so sons are considered the best way to assure support in old age. Our immigration policies also add to the brain drain of professionals from Africa. Canada must commit now to the 0.7 percent of Gross National Produce proposed by Prime Minister Pearson for development aid.

6. Support Education. In the AIDS crisis it is very important that children, especially girls, be educated. Marriage should not be a death sentence. Partners must know if they have AIDS and take treatment. In addition to antiretrovials there are female condoms and biocides that can be used without the husband's knowledge. Treatment can also be effective in lessening mother-to-fetus transmission.

7. Empower Women. Women must have the power in their own lives to name those with AIDS so they can be treated and to end rape or forced intercourse in or out of marriage. This will transform the patriarchal culture that has kept women in subservience for too long.

This means opposing the policies of the World Bank and International Monetary Fund.

Shirley Farlinger

1. *The New International*, May, 2002 "How to Crush Aids" and

The Distinction between Stocks and Flow in Taxes

There are some further remarks regarding taxation that I must sound off on. I feel specially impelled to do so because it has to do with an aspect of taxation I rarely find written or spoken about. Why it is so widely ignored, I can only guess.

Although what I have to say relates most directly to Green County in Kentucky, my surmise is that it is applicable in most states, and that in many other countries laws are not substantially different.

In broad, general terms, what I am concerned with here is not income or inheritance taxes, but taxes on wealth. Wealth in all "advanced "capitalist countries is more unevenly distributed than income. To the extent, then, that valid arguments exist, as they do, for redistribution of income via taxation, similar reasoning applies to taxes designed to bring about redistribution of wealth.

More specifically, what I am concerned with is what, around here, is called the "property tax." Although it boils down to a tax on wealth in the form of real estate – a tax on land and structures thereon. It is thus a tax on wealth, but, not surprisingly, it is highly selective in that it exempts the forms of property in which wealthy people have most of their holdings.

When, long ago, the "property tax" or "real estate" tax was instituted, it was essentially a "wealth tax" since, overwhelmingly, wealth resided in "real" property – in homes, farms, retail stores, and small scale manufacturing facilities. It was not, in the beginning, the unfair and highly objectionable tax that it has been finagled into being today. There was some measure of iniquity even in the earliest days of the tax inasmuch as wealthy property owners were more likely to be able to arrange a low assessment of their holdings by crafty and dubious methods.

They still are. And new dodges have emerged. Many of the industries here in Green County are here because they have been lured by reason of reduced property taxes. Their presence requires increased expenditures on roads, schools, fire and police protection, and so on, and thus requires increased taxes on the property of others.

These considerations, however, are beside my main point which is that the greater part of the wealth of the very rich and even moderately rich people no longer consists of "real" property but as they say, "intangible property" – common and preferred stocks, industrial and government bonds, certificates of deposits and the like. Though termed "intangible, such documents may be touched and handled and are thus very real notwithstanding the confusing terminology. And what is so outrageous about the "property" tax nowadays is that it does not apply to "intangibles." Nowadays, instead of applying to nearly all wealth, it exempts the most common and extensive forms of wealth of the truly wealthy, while falling on the most common form of wealth of farmers and wage/salary owners.

So here in this Kentucky county, a farmer whose real property is assessed at, say, $350,000 must pay about $2900 in "real property" taxes, although a person owning common stocks to the value of $700,000 pays no tax at all on this "intangible property." A wage earner owning a home assessed at $100,000 gets a piddling "homestead exemption" but still must pay a little over $650, while bonds and stocks worth millions pays no tax at all.

My guess if that if all intangible property held by persons in this country were taxed at the same rate as real property, and no real property were exempted, the tax rate could be cut between a quarter and a half and still the same amount of revenue raised. And if all the property – tangible and intangible – in excess of, say $500,000 were taxes at a higher rate than lesser valued property, as it should be, then the rate on small holdings could be reduced even more. And, of course, holdings in excess of, say $1,000,000 should pay a still higher rate, and so on. Wealth taxes should be "graduated" just as income taxes.

The idea that a tax on wealth is an appropriate one is older and was earlier than the idea of a tax on income. In the US, the Constitution had to be amended before graduated income taxes could be levied, although wealth taxes, such as they were, existed all along. Now vast amounts of wealth are immune to taxation although persons with even modest incomes and property holdings find no escape.

Note as well, for example, that farmers are required to pay both a tax on their income and a tax on their most common form of property. Similarly, in the case of wage/salary property. Meanwhile, in the case of intangible property is subject to income tax only. A more unfair arrangement can hardly be imagined.

Whether the economy as a whole can be "fine-tuned" is a subject of considerable controversy among economists, but one thing is certain: over the years, the system has in fact, been fine-tuned so as to lay the burden on people of modest incomes and wealth to make things easy for people of considerable incomes and wealth. When one comes to think about it, nothing is more amazing, even awe-inspiring, than the nicety and diligence with which everything has been so cleverly arranged to assist the rich in growing richer and to keep the poor and the "middle classes" in their place.

William Hixon

March 2004, "More World, Less Bank."

2. Stephen, Lewis (2005). *Race Against Time.* House of Anansi Press Inc., pp. 5, 6.

3. Stiglitz, Joseph E. (2002). *Globalization and Its Discontents.* W.W. Norton & Company, pp, 11-15.

4. Lynes, Krista and Torry, Gina (ed.) "From Local to Global Making Peace Work for Women," www.womenpeacesecurity.org.

5. Ashford, Mary-Wynne and Dauncey, Guy (2006). *Enough Bloodshed: 101 Solutions to Violence, Terror and War.* New Society Publishers, p. 33.

Editorial Note

Space considerations have forced us to condense Shirley Farlinger's excellent report and is the reason for our making a point of including her sources.

We note the highly justified criticism of the World Bank and the IMF, but these are government organizations that apply policies that have been crafted by yet another international organization that cultivates a relatively low profile and does not allow anyone connected with governments to attend its meetings the Bank for International Settlements (BIS). It is an organization of central bankers, and one of its purposes is to promote the view that central banks are independent of government, even where, as in Canada, the government is sole shareholder of its central bank and the Bank of Canada Act explicitly sets out how the Finance Minister may dismiss the Governor of the Bank of Canada if, on a point of basic policy, he fails to comply with the written instructions of the Minister. It was there the deregulation of the world's commercial banks was plotted to release them from the restrictions brought in by the Roosevelt Government's Bank Act that brought the country's banks strictly back to banking, by imposing limits on the interest they could pay or charge, and explicitly prevented them from acquiring interest in the other "financial pillars – stock markets, insurance and real estate mortgages. One by one these restrictions have been lifted and all alternatives to higher interest rates for combatting rising prices but interest rates. In the 1980s the deregulation of the banks had proceeded far enough for the banks throughout the world to have lost much and even more of their capital. To allow them to recoup their capital and much more the BIS 1988 sponsored its Risk-Based Capital Requirements that declared the debt of developed countries to be "risk-free" and thus allowing the banks to acquire it without putting up any money of their own. In 1991 the Canadian government phased out the statutory reserves that had required the banks to deposit a portion of the deposits

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On Unearned Incomes

A recent paper by Michael Hudson[1] points out that contemporary mainstream economists "identify scientific theory with timeless generalities. The basic attitude is that logical consistency is the most important feature of economics, even when the underlying assumptions have little relation to empirical reality." As the subject of his paper, Simon Patten[2], examined systems of economic thought, particularly those of David Ricardo, Karl Marx and Henry George, "to show that the premises on which each of these systems was based were only of transient validity." A few years later this transient feature of systems of economic thought was explicitly adopted and expanded by Edwin R.A. Seligman, a Harvard professor. In a brief chapter of his *Principles of Economics* (7th ed., 1916) he showed how the economic thinking of major epochs in European history, beginning with the Greeks, reflected the physical and social circumstances of the time. Features of economic thought that were later considered to be essential and even obvious did not show up until changed circumstances made previous theories obsolete and inadequate to explain new conditions of life.

Patten's particular interest appears to have been the application of the new approach to economic reasoning that was becoming fashionable in the late 19th century (emergent neoclassicism). His contribution engages the attention of Michael Hudson through its implications for the history and functioning of monetary and financial institutions. That is the orientation that gives a unique flavor and emphasis to Hudson's perspective on the history of thought. His focus in the Patten paper is on important transformations in economic doctrine since Adam Smith. The core issue is unearned incomes, which turn-of-the-century commentators like Patten noted to be increasingly concentrated in the financial sector. An important emphasis in Hudson's applied work is that the FIRE (finance, insurance, real estate) sectors now overshadow the real economy, incorporating many tollgate features. The themes of transition and method in economics are illustrated with the concept of rent that is developed by Hudson in this Patten paper.

The thread begins with David Ricardo and continues through John Stuart Mill to Karl Marx and Henry George, then concentrates at the end on the marginalist revolution with John Bates Clark in particular and his intellectual opponents among the American Institutionalists (Patten especially).

The Analysis of Unearned Incomes

The seed for analysis of unearned incomes was planted by Ricardo. He was active in Britain when the industrial revolution was heating up. At that time and place it seemed natural to assume that laborers were paid just enough to keep them alive and sufficiently healthy to work and reproduce. In that era, the obvious class conflict was between landlords and captains of industry. Ricardo reasoned that the value of goods should be the cost of what went into producing them. That was mainly labor (including the labor embodied in the capital used up in production) and therefore should equal the sum of subsistence wages paid. If the price of goods were higher than this "value," which was normally the case, Ricardo identified the excess as (mostly) a return to property-meaning land. He called this margin economic rent, and described it as accruing to owners of the most fertile soils. The rental element in price was a consequence of population growth and the need to use less fertile soils to produce crops. The price of grain had to cover costs on the least productive soils, so the common price created a premium for owners of the best fields. As population expanded, therefore, so did the average cost of keeping it fed. This meant that the costs of labor for the new industrial enterprises had to go up, making their products more difficult to sell in international markets. Furthermore, increasing prices for inputs to manufacturing, whether due to real scarcity of natural resources or artificially contrived monopolies (tollgates), would further erode profits, bringing investment and economic growth to a halt. The response by Ricardo to this dismal forecast was to urge free trade so that Britain could buy cheaper food abroad, while opening foreign markets to its manufactures. Its agricultural tariffs, the Corn Laws, were duly repealed in 1846.

While international free trade seems "fair" on the surface, it was actually a self-interested policy for Britain. As explained in Ricardo's analysis, decreasing returns to agriculture increased returns to industry. For the latter had been threatened by static productivity of labor combined with higher costs for its subsistence due to the depletion of natural resources and monopoly power over their prices. It was also consistent with the laissez faire tradition following Adam Smith, which urged governments to stand aside on the premise that market forces by themselves would produce the most efficient outcomes.

Discomfort with this analysis began within the classical school itself. As economists from David Ricardo through John Stuart Mill analyzed British land ownership and protective agricultural tariffs they concluded that ground rent and rising land prices were an "unearned increment," to landlords, unearned because they occurred without property owners having to expend any effort of their own. Prices rose due to economy-wide forces. This became an argument for nationalizing the land, or at least its rental income. Rentier income was a class phenomenon in Britain and other European countries. Most rent was taken by the landed aristocracy, the heirs to the original military appropriators and their legacy of feudal economic structures. This made the fight against rentier income largely a class issue. Hudson illuminates this point with a (1908) quotation from Patten: The older thought assumed there was a social class interested in its defense of each sort of income. The social condition of England at the time economic theory was formulated favored this concept. The aristocracy held the land, the so-called middle or industrial class owned the capital, while the great mass of unskilled and politically unprotected laborers did the work. The essence of the Ricardian economics was an opposition to the aristocratic landlords, and it succeeded so well that the imputation of being unearned was put on their income.

Extending the Notion of Unearned Income

Reformers subsequent to Mill took the idea of rent much further. Karl Marx identified another source of unearned income stemming from a power (tollgate) position. Acknowledging and endorsing the labor theory of value, he contrasted the subsistence wage paid to workers to the prices of the products sold by their employers. The difference or profit margin became an index of the degree to which wage-labor was exploited simply by being hired. In Ricardo's analysis, workers generally were paid a sub-

Double-Entry Bookkeeping and Democracy

Few years ago Dr. Welch, a molecular oncologist at the University of Alabama, Birmingham, discovered a molecule that suppresses metastasis, the insidious process in which cancer cells break off from the primary tumor and seed distant sites in the body. He had planned to test whether the gene that makes this molecule, dubbed BRMSI, is turned off in women with metastatic breast cancer. If so, he hoped to design a treatment that would turn the gene back on, test it in mice and then, if all went well, in people.

"But when he submitted the proposal to the National Institutes of Health (NIH), which funds most biomedical research in the US, he was turned down. He had gathered breast-cancer tissue samples from about 20 women showing that a turned-off BRMSI gene is associated with metastatic breast cancer. A 'study section' of scientists who evaluate proposals, however, said he needed data on hundreds of women (which he did not have the money to gather; Catch 22). Absent that, they gave his proposal too low a score to stay above the cutoff at which money ran out."

It should be mentioned that the strictly money costs to even the government, let along society, of breast cancer is immense and growing, and, regarded as part of an investment in human capital to control it would warrant financing every serious research lead to control it. But how can that be done when human capital is not recognized in government accountancy in any part of the world that we are aware of.

Nevertheless in the 1960s Theodor Schultz won a so-called Nobel Prize for Economics for having proved that investment in human capital is the most productive investment a government can make. He did this on the basis of the recovery of the war-smashed economies of Japan and Germany long before economists had predicted they would.

Their error was due to their concentration on the physical destruction in those countries during WWII, while the human stock – educated and disciplined – was left essentially intact. Today, COMER is the only organization that keeps the memory of Schultz's monumental work alive.

But back to *WSJ* article: "And so it has gone for an increasing number of biomedical researchers. Starting in 1995, the budget of NIH more than doubled, with support for scientist-initiated studies rising to $9.7 billion in fiscal 2003 from $4.3 billion in fiscal 1995.

"But in 2004, Congress and the White House, calling for reduced budgets in the wake of tax cuts and a growing deficit, slammed on the brakes. Ever since then NIH's budget has been flat or, adjusting to inflation, down. The chance that a scientist's work will be funded fell to 22% last year from 27% in 1995, and to less than 10% in some fields. Now the warnings are coming true: The plug is being pulled on promising research of scientists with solid track records.

"Alan Schneyer of Massachusetts General Hospital, for instance, has been funded by NHI for 17 years, He recently discovered that when certain gene is disabled in mice, the animals become more sensitive to insulin (the opposite of what happens in Type 2 diabetes), their islet cells make more insulin and they lose abdominal fat. This was a surprise, because the gene was thought to affect reproduction, not metabolism. He wanted to identify the biochemical pathways the gene affected, hoping to develop a therapy for obesity or diabetes. In June NIH rejected his grant proposal.

"NIH was never known for supporting risky ideas, but scientists say it has become even worse with the budget crunch. 'If an idea is more than a little out of the ordinary, they won't take a chance,' says Dr. Scheyer, 52 years old. 'The science they are supporting is not bad science, but much of it is too-safe science.'

"His last NIH grant will run out this month. MGH has given him $50,000 in bridge funding and is trying to help other scientists who are suddenly without NIH support. Dr. Scheyer estimates that some 5% of MGH scientists have only a few months left on existing grants and no new ones in sight. As grants disappear, therefore, it isn't just that studies won't be done, researchers will have to look for another line of work, especially if they are PhDs rather than MDs who can at least see patients to bring in income."

W.K.

sistence wage, and some few lucky landowners captured the rent in the price of their crops. In Marx' analysis, the workers still received only a subsistence wage, and the profits were garnered by well-positioned or cagey industrialists-again a relative few, depending on the degree of tollgate power they had in setting the prices of their products.

By the 1870s the combination of depicting ground rent and profits as being exploitative (especially monopoly profits, which technically were a form of economic rent) turned classical economics into an ideological threat to landlords and capitalists alike. Much to the embarrassment of economists, classical economics was being used to attack rather than promote society's vested interests. "If this new group of thinkers called themselves sociologists or historians they might have been disregarded," Patten observed. But the social reformers "openly claim to be economists, and the worst of the matter is, they have...the mass of the older economists on their side. Nothing pleases a socialist or a single taxer better than to quote authorities and to use the well-known economic theories to prove his case."

This prompted a new school of economists to take a second look at the logic of classical value theory. They "soon realized that their favorite authors were not so perfect as they supposed, and that economic doctrine must be recast" to exclude logic that implied an exploitative character of industrial profit and the "unearned increment" that landowners obtained in the form of rent and rising property prices. A marginal-utility school arose to focus on the psychology of consumers, while attributing all income to the supposedly productive contribution made by its recipients rather than deeming any form of income to be unearned or exploitative. This new generation of economists stopped talking about property and its income, shifting the focus to consumer utility. Public policy was left out of the analysis, exiled to the realm of political philosophy. Government was viewed as a deadweight burden draining the economy with taxes. Mainstream economists turned their eyes within, to become marginal utility theorists and even to mathematize marginal utility to an unparalleled degree.

The approach just described became "neoclassical" economics and originated with the "marginal revolution" led by the Englishman Jevons and the Austrian Menger. Different approaches to the "dismal science" implications of the classical analysis were taken by the German Historical School of economists, and following them, by a school called American Institutionalism. The historical approach emphasized dynamism in economic activity, implying development over time, as contrasted to the static assumptions that underlay Ricardian free-trade theory and laissez faire generally. These economists laid out the conditions for promoting industrial and agricultural technology rather than relying on virgin soil fertility and labor productivity as inevitable elements of increasing cost. This technological approach drew on the chemical view of soil fertility...to increase agricultural productivity, while introducing power driven capital to increase industrial productivity. The result was an analysis of potential costs under conditions of increasing returns in place of the more static Ricardian analysis based on diminishing returns at any given point in time. And in contrast to the laissez-faire doctrine, these economists argued that conditions outside of Britain were so different that government should take the lead in industrializing their nation.

From Pain-Deficit to Pleasure-Surplus

Simon Patten and other young Americans studied in Germany and were strongly influenced by the historical approach. Patten sought an even more far-reaching refutation of British economic thought by widening the range of economic analysis to provide a framework in which Britain and its economic categories appeared merely as a transition phase of development. His framework depicted America not simply as an exception to the British rule but as part of the new dynamic of future evolution. Britain and the rest of Europe were invited to catch up to America by moving beyond their "pain-deficit" organization of class conflict into a "pleasure-surplus" economy under more democratic and forward-looking economic regimes. Rejecting the "one size fits all" outlook that assumed universal validity for British free-market economics, Patten saw that economies could organize their legal and tax systems, educational and social policy in a wide variety of ways. The upshot was a broader and more complex view than that which characterized anti-government free-market economics, especially the marginal-utility school that was replacing classical political economy.

Protectionist ideas in America had long controverted some fundamental assumptions of Ricardian economics, starting with that of the soil having "original and indestructible powers." Whereas Ricardo assumed fertility differences to be immutable facts of nature, the protectionists saw how the South's plantation crop exports depleted the soil, while the catch-up costs of introducing industrial technology rose as Britain extended its leadership as workshop of the world. Rather than specializing and becoming monocultures, countries needed balanced industrial and agricultural growth. The Institutionalists used this observation to argue that it was British free-trade theory that was unscientific. It lacked empirical verification with regard to presumably fixed soil and labor productivity, and assumed as universal the sharp class divisions and subsistence wage levels that characterized 19th-century Britain. British political economy urged governments to stand aside, on the premise that market forces by themselves would produce the most efficient outcomes. But what are markets, the institutionalists asked, if not carefully constructed arrangements that differ from one nation to the next and one time period to the next, shaped by tax laws, government subsidies, educational systems and the cost of public infrastructure. There is no such thing as a "free market."

These timeless and "one-size-fits all" assumptions are hardly a guide for policy of specific countries at given points in time. Attempts to deal with countries abstractly are bound to strip away everything political, and hence are implicitly laissez faire.

Keith Wilde

1. Dr. Michael Hudson, Distinguished Research Professor of Economics, Universities of Missouri at Kansas City and of Latvia in Riga, senior adviser to Government of Latvia.

2. *Simon Patten, Rent Theory and the Rise of American Institutionalism* (not yet published).

The Moment of Reckoning Approaches

The Amaranth Advisors is one of hundreds of major hedge funds whose near-sovereign status derived from their "bigness." Hedge funds are huge investment funds assembled from very wealthy and game-oriented investors as well from pension funds for the retirement of workers. And to obtain still greater leverage for their games, they borrow as much as six times what their shareholders put into play. For heading and devising the schemes, enormous fees and shares of winnings – significantly not of losses – go to their managers. And the "Globalization and Deregulation" of the economy has led to such an excess of funds sloshing around seeking higher returns, at the very time that the boom of recent years is getting by almost every criterion long in the tooth.

These funds are only lightly regulated and often not at all on the grounds that "they were big enough to know what they were doing." That oft-repeated phrase warrants some contemplation, since the purpose of their well-financed efforts are hardly in the interest of society.

That Amaranth went belly-up in natural gas speculations and set the stock markets on their ear was therefore a bit of Judgment Day not only for official policy on hedge funds, but for the Religion of Bigness, of Globalization and Deregulation. *The Globe and Mail* (22/08, "Amaranth's Asserts shares drop 65%" by Paul Waldie) informs us "Amaranth had about $9.2 billion in assets at the beginning of August. It now has about $3-billion."

Gambling with Cards Marked Hurricanes and Gas and Oil

This was achieved by a series of complicated gambles involving wagers on everything possibly affecting natural gas prices, but without necessarily selling or buying, or actually committing to a single actual unit of gas or oil. This involved betting on, at different times and locations, gas storage, available gas reserves, the likelihood of hurricanes in different parts of the continent. But these did not involve shorting or buying quantities of gas; the deals were entirely conceptual and consequently added or removed no gas from the market place. In that respect there is a great difference between shorting the gas "concept" and actually dealing, long or short, in real gas. When a gambler shorts a commodity on the real market, he usually borrows the equivalent amount of the shares he intends to sell. Hence on a contracted date he must buy a replacement to return what he has borrowed to the lender. And that provides assurance there will be an increased demand for the commodity by the amount of the shortage covered. But if the game is entirely with the *concept* of gas, there is no such commitment that will increase demand at a known date. That makes a difference.

That they borrowed heavily from banks to increase the leverage with which they gambled, means that they in themselves had come to determine the market that – conceptually – they were gambling on. And what it amounts to – a human enough trait even at so grandiose a level – they liked what they beheld in their mirror.

Their goal – whether realized or not – was the major part of the problem. Their purpose was to push up the price of gas to where many of their fellow-citizens had to pay 20% or 30% and more for their heating and cooling prices. And for the government even to consider their size as a reason for leaving hedge funds largely uncontrolled fingers a serious problem with our society. The pursuit of "Growth" and the "Increase of the Rate of Growth" and eventual infinite "Bigness" does not come without its price. And in this case it has come with a very much higher one. The Amaranth hedge fund was in fact picking up the script of anti-social corruption where Enron had left off. And that our government should be citing their size and power as grounds for leaving them lightly regulated or not at all, shows how much ground democracy has lost in our countries since the anti-trust legislation of well over a century ago.

The Wall Street Journal (21/08, "Amaranth and the Institutions" by Henry Sender) comments: "The [hedge fund] industry has attracted more than $1 trillion in assets, and a growing portion of the money has come from institutions like pension funds. That means that the $3.5 to $4 billion lost by Amaranth in a single week will be sorely missed. Its effects on the banking systems in the US and Canada must be not inconsiderable, because the banks leveraged up the funds gambled to a reported 600%. Coinciding with the collapse of the US housing boom, that will bring the banks of the world closer to the need for their next bailout."

On Near-money that Becomes Far-money

That should lead our governments to some urgent conclusions. The banks themselves, as we discussed in our last issue, have in the past couple of years or so reversed their previous neglect of humble retail clients. New branches are being opened up instead of being closed down as previously. Instead of pushing out clients from their branches to do their "one-stop banking" with an ATM machine on the sidewalk, banks are lavishing concerns for the humblest client's needs. There is a reason for that.

Our banks dreamt of competing with Japanese banks (some of whom had already stopped their lending because of their losses in Euro-dollars – offshore based US dollars – and many other adventures). What a retail customer brings in, no matter how modest, is legal tender, i.e., cash. Since the 1960s, step by step, the banks have been allowed to take over the other financial pillars – stock brokerages, insurance and mortgages. This has vastly increased the leverage of debt money they can create for each dollar in their possession. From 10 to 1 in 1946, it is now around 800 to 1. The weakness of near-money[1] in these heady days of Deregulation and Globalization is that it so readily turns into "far-money" as for example the massive bank loans that financed the diddlings of Amaranth and other hedge funds.

These gambles involved every aspect real or imagined – the weather, the storage facilities, interest rates, the paths of future hurricanes, interest rates, military developments in an increasing number of areas in the world. And through the use of derivatives – rates of growth as devised by special derivative boutiques run by our banks among others that combine these factors into every conceivable mix, to the point that the purported "risk management" is beyond the understanding of those who devised it.

The time is ripe, therefore, for a new – or perhaps we had better put it the "old" type of banking that helped us out of the Depression, in financing our part in WWII and for a good thirty-plus years of the ensuing peace. The charters of such banks would expressly prevent them from stepping outside the limits of strict banking. Their main purpose would be to look after the investments of pension and other retirement funds, the financing of small businesses, and such matters as financing of the education of diligent students.

This would be approaching the problems raised by the Amaranth disaster from quite the other side. That has become necessary because even at "heterodox" economic conferences banking reform has been a subject strictly off bounds. COMER has repeatedly traced the approach of the next bank bailout, that humanity can hardly afford, or possibly even survive. Today the joint effects of the hedge fund collapses, the US housing crisis, and the deterioration of the Iraqi-Afghan military situation, makes it essential that we attack the banking crisis from every possible angle.

For events have made a mockery not only of the alleged "free market," "there is no alternative" and other assurances that those in charge knew what they were doing in the interest of taking over every thing in sight. Above all they had no qualms about the effects on society, and the world at large. That is left to the tender care of what turns out to be an energy market manipulated beyond recognition by wildly leveraged speculative funds, richly financed by our banks to the point that no one has known how much of the sky-high fuel prices that the whole economy including your average citizen were paying, were due to a drastic shortage of gas and oil, and how much merely reflected that a privileged group playing poker and every other game devised without necessarily owning or actually buying, or consuming a barrel of crude.

The market in this way ceases to be predictable and surrenders every claim to be "self-balancing." The bet simply did not take place on the market but on remote gaming tables with borrowing confined to money rather than commodities. However the entire population of countries and the world have had to pay the prices set by the concept play, and the money won is ploughed back into the same anti-social game whereby the world is stripped of literally billions and trillions of dollars to keep up with the fictitious prices. And these games are adequately financed by the banks that the taxpayers have bailed out on repeated occasions. All this happened with the Long Term Capital Fund in 1998. It is likely to happen again.

Last month another – considerably smaller hedge fund Mother-Rock LP gave up the ghost last month. Natural gas prices have fallen 40% since the beginning of last month – 12% alone last week when the US Energy Department announced that stockpiles of natural gas were 12% higher than a year ago.

William Krehm

1. Near-money is short-term debt that earns interest – unlike the precious metals formerly used as legal tender. Amongst other inadequacies, interest-bearing debt does not qualify as legal tender, because every time interest rates are moved up or down to "stabilize" the economy, the value of "near-money" moves in the opposite direction.

HIV/AIDS *continued from page 14*

made. To manage this financial burden the federal government cut its grants and downloaded social programs to the provinces. The provinces passed on the burden to the municipalities. The municipalities were left with the problem of looking after the growing unemployed caused by those high interest rates. That bank bailout changed the distribution income and power in the nation.❧

Murder *continued from page 3*

of state and the number of oligarchs living abroad, these recent murders and renewed disputes over oil concessions add up to a broader cultural phenomenon. It has aspects of "failed government" to which the American advisers called in under well-paid contracts to plan the new democracy made their own very considerable contribution. Their main concern was an instantaneous privatization of the Soviet economy, even though the state corporations in outlying regions – surely the two oil and gas leases mentioned above would be in that category – depended on the state corporations provided the most elementary services to support their work force and their families. Similarly unprovided were private investors even in Leningrad and Moscow with the capital and know-how to grasp the value of the shares for enterprises in Siberia or in Moscow that had been distributed to them.

In short, it was an absolute ideological version of the "Pure and perfect Market and Deregulation and Globalization with a touch perhaps of a little craftiness by Washington to ensure that Russia with its immense resources does not become too formidable a competitor on world markets in too great a hurry. Washington, by applying its credo that privatized economies in themselves go far to creating democracy, is in a position to appreciate its responsibility for the present bloody message, that is unlikely to stop overnight. On the other hand, strictly Russian traditions made a very parallel connection between privatized concerns carrying out the desires of the government – e.g., Gazprom, the huge gas corporation, undertaking to provide some of the infrastructure and buildings for the Winter Olympics at Sochi to which Putin aspires. The series of high business murders could be a sort of polyphony of pursuing state-desired policies entangled in somewhat extra-curricular methods that come down from Soviet times, and instantaneous privatization as advised by those American economy professors under contract. And over it all hovers a fragrance of failed statehood – compounded of the presence of a distinguished alumnus of the Soviet Secret Service as head of state, the advice of too absolute, too early, too sweeping privatizations according to the advice of the adequately paid American advisers. Even if the present scene falls short of purity and perfection, the State Department as well as the Kremlin both must bear a share of the responsibility.

William Krehm

Extending the Failed Government Concept Closer to Home

As though with a flourish of trumpets, *The Wall Street Journal* (13/09) announces the opening of a new era in Washington's foreign relations. "In April, Saudi Arabia disclosed plans for an unusual and hugely expensive project: a multi-billion-dollar electrified fence along its 560-mile border with Iraq.

"The move angered US and Iraqi officials, but Saudi officials said Iraq's growing instability left them little choice. They said they were concerned about militants infiltrating from Iraq to carry out attacks aimed at either toppling the ruling family or inciting Saudi Arabia's Shiite minority to seek independence.

"Concern about extremism seeping out of Iraq underscores a painful irony in the five-year-old war against terrorism. The US and its allies now face the distinct possibility that the same kind of 'failed state' that gave terrorists a haven when the Taliban ruled Afghanistan – leading to Sept. 11 – could be forming again, in more than one place.

"Both Iraq and Lebanon are threatening to degenerate into states with weak central governments where extremists can thrive. Iraq seems to be already serve as a kind of finishing school for young radicals seeking battlefield experience. In Lebanon, Hezbollah's war with Israel this summer both destabilized the country and enhanced the reputation of Hezbollah, who in the past have demonstrated a desire to extend their reach beyond Lebanon's borders.

"To make matters worse, Afghanistan itself now seems to be sliding backwards to become a terrorist breeding ground."

The US — A Mass–producer of Failed States

In short Washington is clashing head on with the phenomenon of the "failed state." Yet it is their first meeting. However, for the greatest part of its history the United States was a powerful creator of failed states. In Latin America it created them as though with cookie-cutters, overthrowing democratically elected governments in Guatemala, Chile, the Argentine.

Even an eminently democratic president such as F.D. Roosevelt justified its creation and support of the corrupt and murderous dictatorship of Anastasio Somoza ("He is an s.o.b. but he is *our* s.o.b."). Now, however, the boot is on the other foot and wow has it begun to pinch! Only the extraordinary insensitivity of official Washington to the sensitivity of other cultures and countries and to its own history, is impeding its recognition of what is taking place. It has overextended itself into extreme vulnerability at the most basic level by espousing an economic system that must ever expand at an ever-expanding rate that drives it into foreign adventures that it can neither afford nor sustain. At the end of that road lies the danger that US itself risks ending up as the most grandiose of "failed states."

"The violence and instability roiling the Middle East spread to another country yesterday, as Islamic militants armed with machine guns, grenades and explosive-filled van mounted a brazen but unsuccessful attack on the US Embassy in Damascus, Syria. The attack left three of the attackers and one Syrian guard dead.

"This unwelcome picture is forcing changes in America's posture across the region. Most significantly, the US in midsummer abandoned a plan that Gen. George Casey, the top American commander in Iraq, had crafted that would have had the US withdrawing some of its forces beginning this month."

"Instead the number of American forces in Iraq is increasing. In recent weeks the US has shifted thousands of troops to Baghdad as part of an effort to secure the city. Last week the Pentagon said there were 145,000 troops, or 18,000 more than in late July and the highest level since the start of the year.

"Senior military leaders say their top priority is to ensure that Iraq doesn't become a failed state, to prevent it from turning into a place run by fundamentalists who export terrorism to the region. The administration's public comments have shifted markedly in tone, from stressing the benefits of a democratic Iraq to citing the threats that failure in Iraq would pose to the US national security. After several years of benign neglect towards Lebanon, Ms. Condolezza Rice, the Secretary of State, threw herself into crafting and insuring the implementation of a United Nation resolution to create a peacekeeping force that the US hopes will keep Hezbollah at bay.

"Partly to limit Lebanese citizens' attraction to Hezbollah – which provides extensive social services – the US pledged millions of dollars to clean up oil spills and rebuilding wrecked schools.

Other Varieties of Failed States

In its deeper implications a "failed state" is one that cannot carry out what it has contracted to deliver in its agreements with its own citizens – where a measure of democracy exists – or even where national traditions set such standards without legalistic formulations, and in its treaties with other government. And that is why Globalization and Deregulation is the perfect formula for turning out failed states as though on a production line. To enact Washington's vision, barriers were supposed to be torn down for the movement of goods and money across frontiers. But one would expect that this freedom of movement across frontiers would extend to people as well, for governments in one way or another are expected to serve their nations and lead them to greater happiness and prosperity. Hence the paradox of nations that have espoused and even enforced the freedom of goods and money crossing frontiers, should be erecting walls against the passage of people.

But this violence spreading across borders, and not respecting common human relations that are indeed targeted by suicide bombers, destroys more than the confidence between state and state, but basic humanity.

Powering this strange change of scenery and purpose in human relationship is without a doubt Deregulation and Globalization. Without whipped-up thirst for oil, and ever more epic peddle of mass produced American-style goods from wherever on earth is cheaper, is particularly destructive in countries where money plays a far lesser role in human relationships, and hence traditions, religion, warm clan loyalties mean far more. These bristle defensively when highly promoted commercial life styles between sexes and generations are promoted. There are other paradoxes that ignite hostility. Whereas free passage of frontiers is promoted for goods and money, the opposite is the case with people. Certainly the fence that is proposed on the Mexican frontier – to keep out workers many of whom are desperately needed by US agriculture and many industries. And for that matter the new ships that are being introduced to patrol the Great Lakes frontier, equipped with powerful mounted machine-guns whose preliminary exercising is leaving a lot of poisonous lead in the waters and endangering pleasure boats that swarm in many lake areas in the season. There is right there a contradiction between a world opened for goods but impeded for humans. That should be taken as a warning that Globalization and Deregulation may delay Wall Street's periodic crashes, but it could end up making the US itself a "failed state." The transition – as was the case with Soviet Russia – could come suddenly and too soon to do anything to prevent it.

William Krehm

On Jews, Israel and Northern Manitoba

I am of Jewish origin and have never been a practising Zionist, though I used to make modest contributions to an organization of Jews and Arabs in Israel called "Peace Now." I am happy to read that it is resuming its activities after some years of despondent inaction. However, I am impressed by the foresight of Theodor Herzl, inspired by the wave of anti-Semitism, that swept France and Europe at the time of the Dreyfus Affair in the late 19th century. That led him to organize a homeland in Palestine for refugees from European persecution. Had Israel not have been there in the 1930s to accommodate a desperate emigration, the Nazis would have been put to the trouble of putting up another few death camps. It was a time when a high official of the Canadian immigration department was heading a report on Jewish immigrants "One is too many."

Recently, I had lunch with a gentile friend with whom I have had a variety of dealings over the years, and than whom I know no finer person. And the conversation inevitably turned to the Lebanese fighting. He remarked, "As my friend out West remarked to me: 'Having the Allies after World War I cut a homeland for the Jews out of Palestine, was like someone offering them a homeland in Northern Manitoba.'" Not quite, I said, you know they are related to the Arabs and Hebrew is certainly far closer to Arabic than Russian is to English among Indo-Germanic languages. They are both Semitic tongues. He was surprised to learn that. I also told him that though conquerors had exiled the Jews from Palestine, they found their way back so that there was a continuum of Jewish population in much of present Israel for millennia. He came to realize that the Northern Manitoba analogy wouldn't quite fit. But Christians should know from the Old Testament that Jehovah, a tribal god at the time, gave Canaan to Abraham "in perpetuity." Tribal gods, however, have been falling out of style, and Jehovah's generosity may have had the effect less of a claim than a source of Israel's troubles.

But that friendly interchange preoccupied me, and on returning home I reached for the *Encyclopedia Britannica*, Edition 1976, to check on just how continuous Jewish occupation of what so many different peoples call the Holy Land. Here is what I found:

There was not one exile, but in fact at least two or three. For as early as 587 BC Jews plotted a revolt against their Babylonian conquerors. It was after the Persian King Cyrus defeated Babylon that he allowed the Jews to return to Palestine and rebuild their temple. 40,000 Jews went back, and the Samaritans – a mixture of Jews and Gentile deportees, were a product of that exile. A good many Jews, however, settled throughout the Mediterranean. In early Christian times 700,000 to 5 million, Jews have been estimated to have existed in Palestine. However, according to some guesses, Antiochus III 247 to 187 BC treated Jews liberally and Jerusalem was virtually a Greek-speaking city. In 139 BC many Jews were forced to leave Rome and return to Palestine and converted many of the then Palestinians to Judaism. The Babylonian Jewish rabbis of this period set the law for all Jews right to the 12th century AD. In Spain Jews wrote Hebrew poetry to Arabic meters. Jewish savants flourished in mathematics, medicine, philosophy, and were ministers of the Crown. It was the golden age of Hebrew culture. Highly cultured Jews were respected members of Hispano-Arabic society. Christian monarchs expelled Jews and Muslims who refused to convert from Spain. Years later a rabbinical community established itself in Safed, in Palestine and studied the rich Hebrew literature from different locations and times. That colony is still there, and is one of the more touching tourist attractions.

The Many Returns from Exile

In the 1920s and 1930s there was a powerful wing of Zionism that sought to bring Jews back to agriculture that many Christian countries had banned to them. Of this Cooperative Zionist movement there was in turn a wing that sponsored the use of Yiddish rather than Hebrew as the language of Israel, but met with opposition that at times seemed persecution to them. Yiddish is a bowdlerized version of southern German, with an admixture of Hebrew words, and in the case of Eastern Europe Slavonic borrowings. But in Hebrew itself there are also not infrequent Persian roots – a reminder of the friendly treatment of the Jews by the ancient Persians who, as mentioned, hosted one of their exiles and allowed them to return to Palestine. The Spanish-speaking Jews, once the aristocrats of the race, came upon hard times when many of them were expelled into North Africa, after a wave of Berber Muslims overran Spain. Some of these came back to Israel as the most humble of the humble in recent decades. They speak a version of medieval Spanish "Ladino." These are known as Sephardim – from the Hebrew name for Spain, while the Germanic-speaking Jews are known as Ashkenazim. Hugh Thomas, the great British historian in his recent *Rivers of Gold: The Rise of the Spanish from Columbus to Magellan*, writes than in the time of Ferdinand and Isabela and Christopher Columbus, "just about everybody who was anything in Spain seems to have been a converted Jew (*converso*)." If they relapsed and were found celebrating the Sabbath in secret, they were burned by the Inquisition – at least 1000 of them in the city of Seville alone. The spots for the process can be found even throughout much of Latin America – in Mexico City, for example, in the central Alameda park.

It was a varied if not necessarily an easy life. One might say that some of them may have earned a spell in heaven. Of course, provided that they brought along an Arab friend. A propos of which, Haifa the beautiful North Israeli port city with a Bahai center dedicated to human brotherhood overlooking it from on high, is a joint Israeli Jewish and Arab city. For there is a considerable native Arab Israeli population that did not flee during the 1947 war and have enjoyed full rights as Israeli citizens. It was, of course, heavily bombarded by Hezbollah in the recent war. There is enough intimate common history between Jews and Arabs to make possible more useful interchanges than artillery shells. That should be cherished and nurtured.

William Krehm