THE JOURNAL OF THE COMMITTEE ON MONETARY AND ECONOMIC REFORM

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$3.95 Vol. 19, No. 10 • OCTOBER 2007

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A Great Forgotten Son of Canada

In many respects we have been deprived of a crucial part of our history. The best way to describe our plight is by comparing it on a monumental scale with our computer swallowing our key files. Practically, all public and university libraries, coast to coast, have purged their shelves of crucial books that offend the mighty on important matters. That has been the fate of one of the most gifted men to have come from Canada, Gerald G. McGeer, Mayor of Vancouver, member of the Canadian and British Columbian legislatures and the federal Senate. He was the man who in the depth of the Great Depression of the 1930s raised the banner of monetary reform. More than anybody else he was responsible for pressuring Prime Minister William Lyon Mackenzie King into nationalizing the Bank of Canada some four years after it was founded.

It wasn't cheaply that Canada bought out the 12,000 shareholders of the central bank. The knowledge of what Canada got back from that deal has been buried deeply beneath the sod. Life rolls on as we repeatedly go on bailing out our deregulated banks as though Canada's purchase of the Bank of Canada had never happened. Yet the repurchase of those shares helped save this land during the war. During the three decades after that conflict, it financed much of Canada's transition from a semi-rural into a developed land. Since the 1980s and especially the 1990s it is never mentioned by the government though the *Bank of Canada Act*, is still intact on our law books, unused, when it comes to the crucial matters for which it was nationalized.

Today, for example, our government is selling off its choicest urban real estate because "it cannot afford to maintain it properly" even though it has not only a bank, but a central bank at its orders. Subsection 14(2) of the Act makes clear who has the final word in such matters. After the sales of these properties it is leasing them back on 25 years leases. With the second major bailout of our banks in little more than a decade, we should try foreseeing what form the next apparently inevitable bank bailout will take. It could be the reprivatization of the Bank of Canada on the US model. Today, accordingly, Canada needs McGeer's books more than it even did in 1935.

McGeer's achievements began with a lengthy, warming-up battle against the railways to curtail the injustice in the rates charged British Columbia. under the Crow's Pass system. Right from the beginning you sense that behind the man, his several publications, and his practical politics lay a rarely gifted mind mated to an exceptional valour.

I have spent close to a half century engaged in monetary reform. Never, however, had I quite encountered McGeer's ability to concentrate in a single phrase what banking or many other matters are about. The banks, said he, "sold the public what they didn't have, or in other words *they sold money short*. And for that the only thing needed is the absence of a conscience, since it transforms on a potentially ever larger scale the need of the borrower to surrender to the creditor." Try to improve on that!

A High School Dropout with a Mind on Fire

I have encountered elsewhere that type of gifted mind, where its owner as an adolescent becomes impatient with school courses, and before you know it has dropped out of school to learn better alone, entrusting to

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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
Email: comerpub@rogers.com
Website: www.comer.org

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***Economic Reform* Subscription only:**
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***ER* Back Issues:** CDN/US$4, includes postage; additional copies same issue, $2; additional issue same order, $3. Send requests for back issues to Herb Wiseman, 56 Robinson Street, Peterborough ON K9H 1E8.

Publications Mail Agreement 40018485.

Postmaster, please send address corrections to:
COMER Publications
245 Carlaw Avenue, Suite 107
Toronto, Ontario M4M 2S6

LAYOUT
Tony Koch (comer@pagecraft.org)
Pagecraft Computer Services

PRINTING AND DISTRIBUTION
Watt Solutions Inc., London

Printed in Canada on recycled paper.

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his own scouting what course to take, where, and when. That happened to McGeer in his mid-teens and he went to work as a metal moulder, and even became a militant member of the moulders' union. But then he realized that to effect social change, he needed a position of some influence. So then in a few months he prepared for university and took a law course. He did a similar job on monetary theory, and came under the spell of the late President Lincoln, author of the Civil War greenbacks, paper money bills with nothing except everything behind them, that is the government's entire credit.

Even today McGeer's books – brilliantly and leanly written – leave an opponent floored bleeding with cutting insights. They are, however, not to be found on even Vancouver public library shelves, either academic or municipal. Yet they brought this land the nationalization of the Bank of Canada, largely because Prime Minister Mackenzie King, leader of the opposition during much of the Depression, could simply not withstand the dynamism and passion of McGeer's mind. How much Mackenzie King appreciated what McGeer was talking about, apart from its immediate political convenience, is open to discussion. The Canadian Cooperative Federation, forerunner of the present NDP, should rate higher in this regard, but never risks mentioning the important role of its predecessor in supporting the nationalization of the central bank. That, however, alone made possible the transformation of Canada into an actively social-minded democracy during at least three decades of the post-war.

It was due to him as much as to any single person that the Bank of Canada financed 16% of Canada's war expenses virtually interest-free through the federal bank – a considerably larger percentage than either the UK or the US, both of whose private banks were privately owned at the time. The US Fed still is.

Occasionally his writings may be possibly too laden for our generation's secular taste with Biblical references to usury, and to Christ casting the usurers out of the temple. Yet that is a sin readily to be forgiven when the suppressed message is so important for saints and sinners alike. I owe the copy of his *The Conquest of Poverty* that I am reviewing to a loan from Betsy Wood who runs a small non-commercial private library of McGeer and works to keep his flame glowing. The tales that McGeer tells in it are simple, unadorned, overpowering. No wonder those in the saddle want to avoid encountering them on the printed page, in their sleep, or in libraries, before or after sunset.

Learning How to Finance Peace from the Lessons of War

Here is an early sample, on *Financing War*, that leaves no doubt about how to finance a durable peace: "Just twenty years ago the governments of the leading nations of the world were confronted with the problem of financing a war to the fabulous sum of $400,000,000,000 in direct governmental expenses and an additional $400,000,000,000 of loss due to the destruction of property and the curtailment of productive activity. When the war commenced, many laboured under the delusion that it would not continue indefinitely simply because the cost would exceed all the money in existence. As it turned out, the longer the war continued and the greater the expense grew, the easier the problem of financing it became.

"During the war some 65 million men were mobilized as combatants, and all were carried on governmental pay-rolls. Another army even greater was engaged in producing army supplies and war materials. Yet there was never any shortage of money to meet the current cost of the War. For a period after the war, prosperous times continued. Eleven years after the Armistice was signed, however and just four years after the gold standard was reestablished in Great Britain the world's most tragic depression commenced. From one end to another of Christendom, governments acknowledged bankruptcy. Debt repudiation became the order of the day. Huge armies of unemployed and destitute workers appeared everywhere and democratic government fell into a condition of impotence. Strange, is it not, that while there was a plentiful supply of money for the war, that with peace a shortage of money for peace should everywhere appear?

"Thus we see that the comparative shortage of money which we now suffer in peace as contrasted with its abundance in war time, is due to a definite and specific change in monetary policy. These extraordinary results have been accomplished by the simple process of suspending and restoring the gold standard to create an abundance of money. Surely if money can be provided when the primary purpose was to finance war, there can be no good reason why there should be a shortage of medium of exchange required to finance the production and distribution of wealth for work in the advancement of a cultural civilization. War-time and post-war policies prove that is the most important and far-reaching of all the powers of modern government."

Let us move on to yet another overpoweringly simple treatment of an ancient cliché by McGeer: our inescapable, old friend, Supply and Demand (p. 4): "The law of supply and demand is a fundamental law of nature. But, like money, its real meaning and true purpose are little understood. Of course, everybody is subconsciously aware that no one can survive who does not eat, drink and shelter the body and throw off the materials required to sustain life, that the instinctive drive to live creates. This determines that the demand for life's requirements will always be satisfied by human intelligence from whatever supply there is of life's necessities.

"[But] while progress is dependent upon the demands of the human family for necessities, it is possible to interfere with this law so that progress may be delayed, notwithstanding that both supply and demand do exist. An improper administration of the monetary system produces this evil result, let us examine the part that money should play in helping the law of supply and demand really function.

"During civilization's progress, mankind has moved from a condition of natural existence, when the business of life's existence was purely an individual enterprise, until today, when individualism has ceased to exist and life now depends on collective effort. When advancing intelligence made life more secure and comfortable and convenient living became possible that created a demand for a medium of exchange.

"Money was invented to satisfy this demand. It is therefore a simple tool of trade, man-made and man-controlled. It was invented to assist the law of supply and demand in the realm of progress. Primarily it should serve the purpose of helping unlimited numbers of people create and distribute wealth in human service through an effective division of labour and intelligence.

"Like water in an irrigation system, money must be circulated in the social system as the means of sustaining the production and development of life's needs.... Today, however, under the private monetary system it is primarily used for acquiring wealth. The private money system has changed from a simple tool of trade into a power that negatives the law of supply and demand, and appropriates to the service of the few the entire wealth-creating power of modern civilization.

"The power to create, issue and circulate the medium of control, which should be recognized as the supreme prerogative of government, now forms the stock-in-trade of the business of our super-banking system. This functions as the servant of usury in the realm of high finance.

"No factor has played so great a part in this unfortunate development as that of the gold standard. It was designed to prevent governments exercising their power to issue currency as a medium of exchange serving human needs. The production of gold, and not human needs, fixed the volume of currency in issue. The supply of gold, as this depression has compelled us to realize, bears no relation whatever to the capacity of the people to create and distribute wealth in the service of mankind.

"Fortunately for humanity, such monopolies are always blind. Dominated by greed, they invariably sow the seeds that produce their own destruction. The private money system, having secured the power to limit the supply of money so that all – government, corporation and individual – would have to borrow at interest, proceeded to pyramid obligations into a mountain of unpayable and inextinguishable debt claims. The private money system having thus made progress impossible, it must now give way to a governmental administration of the monetary system."

A Hard Look at What WWI Taught Us About Deposits

Since the war, bank deposits have been much more carefully considered than ever before. The bankers have as a result been able to create bank deposits by the simple process of making credit entries in their own books. (See Table 1.)

Thus during the war period the banks more than doubled the total amount of moneys alleged to be on deposit.

In *Economic Reform* I have written on this phenomenon: "The bank multiplier gets applied to the liquidity pools of each type of non-banking corporation in turn. As a result money creation at the previous level becomes mixed up with the legal tender or near-money base at the next level. Hardly surprising then that the multiplier I had tracked down mounted from the 12 in 1939 to 376 in mid-1998. But that of course was before even relatively simple derivatives had been brought in to befuddle the figures further. In view of the commotion around the millennium change, I threw in the sponge around 2000 in trying to identify the rapid growth of the bank multiplier – because the difference between denominator and numerator of the key ratio had become too indistinct. But given the notable structural developments since then, every glimpse of the clefts opened up in our economy, becomes informative."

McGeer's observations on the changed role of taxation in a society that has learned to handle its monetary system. could not be clearer:

"Here then we observe that the power of the government to create money places it in a position to finance all public enterprise without cost to the taxpayers. But there is something even more important than that. By this course the government is able steadily to increase the volume of consumers' buying power required to serve the demands of progress. For example the $100,000 the government has spent in payment for, say, a school has gone into circulation. It has been used by all those engaged in providing the material and labour out of which the school was created with buying power. They in turn have bought the needs and comforts and conveniences of existence. The social system is thereby enriched by an added volume of medium of exchange put into circulation as a result of the creation of the real wealth of the school. The community at large has a school representing real wealth in the value of $100,000 and $100,000 in buying power. The books are balanced.

"There is the cost of maintaining and operating the school, of course. But when the government creates its own paper money or credits in a national banking system to finance the school's operation, a continuous stream of purchasing power is put into circulation. That increase is required to support the greater demand for the increased buying power needed to purchase the increasing supply of comforts and conveniences which educated people desire.

"Now let us assume that all the public works and social services now being maintained on a niggardly basis by national, provincial, state and municipal authorities were financed by the issue of national currency and credit. and the government were under no obligation to arbitrarily withdraw from

Table 1: Bank Deposits
(millions of dollars)

	UK	Canada	US
1914	5,000	1,000	18,000
1920	11,500	2,400	37,000
Increase	6,500	1,400	19,000

circulation any sum other than the power necessary to maintain the effective buying power of the exchange medium. Governments could then usher in an era of progress in governmental service to the people that would eliminate any suggestion of unemployment. Wages could be maintained at all times and in all circumstances. People could be paid to go to school if there was nothing else for them to do."

No Government Need Suffer Bankruptcy While Its Power to Create Currency Is Not Fully Used

"No government need suffer bankruptcy while its powers in the realm of currency and credit remain unused. To save itself from destruction by the dictatorship of the Money Power, democratic government must establish a national banking system. In making the change, it should be recognized that national banking and commercial banking are and should be treated as separate and distinct functions in the monetary system. The national banking system should be confined in its operation to the creation, issue and regulation of the circulation of the domestic and international medium of exchange necessary to maintain government and the trade and commerce of the nation. The merchant banking system should be confined to the business of serving the private commercial needs of the nation. The former is essentially a private enterprise, while the latter is a normal part of the private enterprise of a capitalistic system."

Here we have a sober disposal of the notion of "100% money," that even argues that any sort of banking is "immoral." "100% money" arose inevitably during the Depression depths in the 1930s. When a single bank closes its doors. unable to honour the claims on it, it is often enough to start a run on all banks. Imagine then the situation at the time of President Franklin Roosevelt's first inauguration in 1933, when no less than 38% of the many thousands of US banks had done so. Roosevelt had to declare a bank moratorium to meet the emergency, and on its expiry to renew it. Inevitably many theorists gave up on capitalism and banking – included amongst these were Henry Ford and Thomas Edison – two very eminent industrialists. As did many economists for a while. But when the banking system and capitalism recovered after having been put on a severe regimen with no small help from World War II, the Hundred Percent Money prophets mostly changed their beliefs and reverted to orthodox capitalism. Even some of its most aggressive people passed through these stages – Milton Friedman, for example. However, a few lingering zealots, mostly belated discoverers of a portion of the intriguing record of banks and banking who announce that fractional reserve banking is in fact "immoral" and hence must be abolished.

One should not too readily proclaim institutions that reach back several centuries fit only for abolishing, without having carefully studied what purpose they may have served and what serviceable and more humane institutions are available for their replacement. Slavery itself was not only continued for centuries during which in theory the Catholic church was opposed to it. William Wilberforce and his effective stand against slavery significantly followed the spread of the steam engine that offered a substitute for humans as power engines on land and sea. It also contributed to the supply of precious metals which replaced slaves as a medium of exchange.

In trying to deal with the problems of an ever accelerating, ever more globalized and deregulated economy, made subject to a compulsion of exponential growth to continue gaining altitude to survive, our 100% Money friends should bethink and answer how are they going to bridle and command this beast. Through the identical government apparatus that is already so helpless at running its own specific affairs?

In his work published at the depth of the Depression McGeer avoids stepping into prophet's. robes, and keeps the basic economic implications of money in mind. To achieve this, he makes a rational distinction between public and commercial banking.

It was his clear thinking on the subject that made possible his break-through in his campaign to nationalize the central bank. A central bank requires a different type of person and organization than one that looks after the affairs of the country as a whole from the commercial needs of individuals and commercial corporations. And commercial banking in turn is developing apart from consumer banking payments such as credit cards not only for the benefit of financing companies' but for individuals' purchasing funds and financing. To thrust this onto a single breed of executive is to play with fire. To begin with these consumer financings require a different technology, which can be very costly Not only more costly, but the private banks kept out of banking proper will have to make up with higher fees, or openly or hidden higher interest charges. This will have to be collected whether they appear as interest or as straight fees. Entrust that to a government bank, not only with different technologies, but with technologies that are changing all the time, could only mean that the effective commercial interest charges will move up We would be wise to consult McGeer on this matter while reclaiming the social advantage of his great legislative victory.

First he settles accounts with the gold standard as a useful means of handling any contemporary social problem (p. 57): "We have learned that the promise that economic and social security could and would be sustained by the management of the private money system cannot be fulfilled. In addition to that, we have been compelled to recognize that the international gold standard is not an effective means of regulating international trade and that the adverse balances which unmanaged international trade develops cannot be paid out of the gold reserves available. In the future we must, therefore, segregate monetary from non-monetary factors and recognize that monetary management, other than providing the economic power which an effective circulation of the medium offers, should have little or nothing to do with the control and regulation of factors and institutions which are purely social, economic and political. In the past, our inability to segregate and administer monetary and non-monetary factors has been very largely responsible for the impotence of government and the failure of our monetary system."

Enter a Hint of Systems Theory Before Its Day

This approaches the basic view of "systems theory," long familiar to scientists and academics. This regards society and the economy, too, as a structured complex of systems composed in turn of subsystems, each with it own code that must be respected for the entire super-system to function. Clearly this was incompatible with the official economic doctrine that sees everything in the economy determined by a "pure and perfect market," defined as of such infinitesimal size that nothing done by individual agents can affect price. All this, of course, was in order to apply some infinitesimal calculus which is mistaken per se as a guarantee of scientific validity.

Let McGeer himself tell his tale (p. 59): "Communal life is sustained in much the same way [as that of private citizens]. An inexhaustible supply of the medium of exchange must be established. This is now available. The means of maintaining the medium of exchange in circulation must be developed. Wages and consumers' buying power must be sustained and new capital must be issued as required from time to time. Once this has been done, the monetary system can begin its work. What they will produce, how they will use it, the type of social system they maintain and the cultural progress they achieve, depend upon the intelligence and industry of the leaders in the innumerable structures of the social system. The work of national, provincial, state, county and municipal government must be coordinated to the end that all contribute towards achieving ordered progress.

"Governments with power to create and issue money and credit need not borrow capital. By the adoption of a sane attitude towards money and credit, the financing of public works and social services can be changed from one of disastrous expense to the taxpayer into the general betterment of the social system, In making the change, it should be recognized that national banking and commercial banking are, and should be treated as distinct functions in the monetary system. The national banking system should be confined in its operation to the creation, issue and regulation of the domestic and international medium of exchange necessary to maintain the government, trade and commerce of the nation. The merchant banking system should be confined to the business of serving the private commercial needs of the nation.

"I am fully aware that the reconstruction of the private money system is not in itself a panacea for all economic problems that confront us. We have been compelled to recognize that the international gold standard is not an effective means of regulating international trade and that the adverse trade balances which unmanaged international trade develops cannot be settled by the gold reserves available. In the future, we must then segregate monetary from non-monetary factors and recognize that monetary management, other than providing the economic power which an effective circulation of the medium of exchange offers, should have little or nothing to do with the control and regulation of factors and institutions which are purely social economic and political. Much of the failure that now exists is due to the fact that we have assumed that progress could be controlled by those empowered to regulate the flow of the medium of exchange in the social system. We should have known that progress is wholly dependent upon education, for it is upon the advancement of intelligence that we must depend to provide administration with increasing efficiency."

Here you have the view that investment in human capital – in education, skills, and hence in the preservation of the vessels holding these valuables – human beings – is the most productive investment a country can make. Theodore Schultz reached that conclusion in the 1960s based on his own mistaken forecast and those of hundreds of other American economists sent to defeated Japan and Germany to predict how long it would be before those two powers would once again become formidable industrial competitors on the world market. Schultz concluded some 20 years later that he and his colleagues had guessed so wrong because they concentrated on the physical destruction and ignored the fact that the highly educated labour forces of those powers had come out of the war essentially intact. It netted Schultz a so-called Nobel Prize from the Bank of Sweden, but after a decade or so his achievement was forgotten, After all, at that time governments were still and more

More than a Mat at Doorstep to Clean Up Coal

The Globe and Mail (10/9, "Clean Uses of Coal" by Kevin Bambrough, Sprott Asset Management), informs us: "Allen Wright, CEO of the Coal Association of Canada, sees the future of coal through a pragmatic lens: 'There's no doubt that we'll continue to rely on coal as a valuable part of the global energy mix. Considering Canada's significant coal resources, it is not a question whether we will continue using coal, but how can we use it better.'

"Canada has at present sufficiently proven coal reserves to last more than 230 years. Rising concerns over energy security and the environment have led to concerted efforts to deploy technologies that will enable the use of all this abundant resource responsibly and maximize its economic usefulness.

"With 12 billion tonnes of near-surface coal reserves, Sherritt is Canada's largest coal producer. Company spokesman Michael Minnes says, 'There is no question that coal will be part of the energy mix moving forward. It makes sense to embrace the asset and the technologies that enable its responsible, profitable use.'

"Among the innovative options being pursued by Sherritt and others is coal gasification, which can be configurated to produce efficiently synthesis gas (syngas) of hydrogen, as well as electricity, steam, and a host of industrial byproducts through a near-zero emissions process.

"In Ottawa, Natural Resources Canada research scientist Bruce Clements heads the CANMET Combustion Optimization Group. He says a key function of a gasifier is to convert coal into syngas.

"'Once you have syngas, it can be used to produce hydrogen, which is very important to oil sands processing,' says Mr. Clements, who adds, 'Chemicals produced by gasifiers could be adapted to produce nitrogen for fertilizer, chemicals for almost anything – polymers, plastics.'

"Mr. Clements says an Integrated Gasification Combined Cycle (IGCC) facility produces electricity by combusting cleaned syngases in a turbine and by capturing waste heat, which is exhausted to generate steam in a boiler. 'This way you are running a gas turbine cycle and a steam cycle.'

"'When CO_2 capture and sequestration technology is added, an IGCC is a near zero-emissions polygeneration facility. Even its waste CO_2 – a greenhouse gas – can be used for industrial purposes such as enhanced oil recovery, or stored safely underground. Mr. Minnes says that while IGCC technology has been successful in countries around the world, it is new in Canada. Sherritt's proposed Dodds-Roundhill Coal Gasification Project in Alberta has the potential to incorporate an IGCC facility into the overall footprint of its gasification project, which would make it Canada's first fully operational IGCC facility.

"The production of syngas through coal gasification would provide an alternative to natural gas now used to produce stead steam and hydrogen for bitumen extraction and upgrading.

"He adds, 'With IGCC, you use a low-ranking fuel (coal) to create high-value products. It is a responsible use of fossil fuel with low to zero impact on the environment.'"

That sounds to our ears as a giant patter of steps in the proper direction.

W.K.

desperately writing off even their physical investments – roads, bridges, battleships, buildings in a single year since it helped create misleading deficits on their books to push down labour costs. And here was McGeer some thirty years earlier having reached the same key conclusion without the guidance of a world war! It was a conclusion that could have saved anything positive that came out of WWII. Instead we seem well launched towards the next world conflict.

A Chat of Roosevelt with Abe Lincoln

In the McGeer book being reviewed, there is a reference – during a long imagined interview between President Franklin Roosevelt and Abraham Lincoln who did issue his paper greenback money with no gold or silver reserves. In this McGeer pursues the main purpose of counselling the new President of the United States Franklin Roosevelt through the mouth of Abe Lincoln who may not have thought out monetary theory in all its scope as McGeer did.

Mr. Roosevelt is presented asking of Mr. Lincoln filling in for Mr. McGeer: "Other than your speeches and messages to Congress, have we available any authoritative modern opinion that now endorse and recommend the ideas you proposed to Congress during your Presidency?

Mr. Lincoln: "Yes. The Committee of the Committee on Finance and Industry appointed by the British Government under date of November 5, 1929, which sat under the chairmanship of the Right Honourable H.P. Macmillan, KC, now Lord Macmillan, filed with the British Government under date of June 23, 1931. It ruthlessly exposes the misguided nature of the fundamental fallacies that bankers and financiers have tried to maintain. The report recommended an entire change in monetary management by stating: 'It is not advisable or indeed practical to regard the monetary system as an automatic system grinding out the right result as an automatic system of natural forces aided by a few maxims of general application and some well-worn rules of thumb. The main objectives of a sound monetary policy which are, among others, the maintenance of a parity of foreign of the foreign exchange without unnecessary disturbance of domestic business, the avoidance of the credit cycle and the stability of the price level, cannot be obtained except by the constant exercise of knowledge, judgment and authority by individuals placed with all the resources and every technical device at their disposal.'

"The report was made at a time of great uncertainty, when the people of Great Britain feared the consequences of abandoning gold. For that reason the report was guarded and less pointed than if it were by the same men today. However, from the main report and the observations filed by Committee members, an almost complete scheme of managed currency, and planned economy and regulated trade may be secured.

"Let me draw to your attention the following observations to be found in the report.

"National Banking

"1. The Bank of England ought to be formed into a public corporation. (p. 240)

Public Credit

"2. The vicious circle is now complete. The decline of new enterprise has reacted adversely on profits and prices, and the low level of prices stands in the way of new enterprise. It is for this reason that some of us think it may be necessary to invoke governmental enterprise to break the vicious circle. (Section 316)

"3. The best hope of a remedy lies in a policy designed to increase the volume of purchasing power.

"4. It is not necessary that the volume of note issue (*a fortiori*, of the creation and the issue of national bank credit) should continue to be regulated as now by reference to the amount of gold held in reserve. (Section 148)

"5. Since the bankers as a whole under banking practice maintain a cash proportion of not the amount of gold which may be held in reserve (i.e., the legal tender paper money borrowed from the Bank of England or the Department of Finance in Canada [the Bank of Canada was still not founded even as a private institution at this time]), the bulk of the bank deposits arise out of actions of the banks themselves, for granting loans, allowing overdrafts and purchasing securities, as banks create a credit in their books which is treated as the equivalent of a deposit of money. (Sectors 71-74 inclusive)

"6. The theory that government expenditures in the promotion of public enterprise and social services is restricted to the accumulated savings available for investment, is erroneous. When governments distribute wages by financing public enterprises with national currency and credit, the volume of capital for investment is increased. (Section 47 of Addendum I, page 203 and section 24 of Main Report)

"7. If governments pursue an inflationary policy, i.e., meet expenditures not out of revenue, but by the issue of paper currency (or the creation of credit in a national banking system) forces are set in motion increasing profits and wages and additional spending arises. (Section 24)

"8. Gold reserves are held solely to meet temporary deficiencies in the balance of international payments. (Section 340)

"9. The circulating media consist overwhelmingly of paper money and bank deposits. It is this volume of purchasing power that deeply affects the price level and not the amount of gold which may be held in reserves. (Section 45)

"10. There is nothing inherently impractical in the government's power to deliberately control the price level. We should be ready to attempt the task to gain experience by practice. (Section 210)

"11. International trade can and should be regulated and controlled by deliberate management. (Section 41, Addendum I, page 201)

"In the broad principles and administrative policies laid down by the Macmillan Committee, there is nothing proposed that is either unique or new. The recommendations it offers are based on the truths that the ancient Hebrew writers recorded as the inspired laws presented to humanity under the direction of God. They recommend the management of the medium of exchange."

Are We Preparing the Ground for WWIII?

There was something that at first sight seemed unbelievable. Here in our enlightened land there had been a native son – remote from the great centres of learning – had on his own, disentangled better and earlier than John Maynard Keynes himself the mysteries of money. For during the first year or two after the crash of 1929 – as in his *Treatise on Money* published in 1930 – Keynes was still considering using interest rates *"a l'outrance"* before abandoning that omnibus prescription of equilibrium theory. And by then McGeer must have been deeply involved in rethinking the whole corpus of economic theory. let alone putting it into Biblical terms and into the mouth of Abe Lincoln. It was only with his final magnum opus, *The General Theory of Employment, Interest and Money* that first appeared in 1936, that Keynes finally parted way with benchmark interest rates to keep society on the straight and narrow path.

That difference between continuing suppressing the work of McGeer and giving it the attention that it so dramatically had earned could be no less than World War III!

But before I chose that conclusion, I felt I had some checking to do. Why did Keynes and other distinguished university-trained economists tarry so long even after the 1929 crash and the Depression, which had driven industrial magnates espousing 100% money? Why did bank and academic economists still cling to interest rates as the means to a balanced economy?

A couple of hours at the University of Toronto Library confirmed that the books of McGeer are distinguished absentees from its shelves. Two copies of his *Conquest of Poverty* have received shelter at the University's Catholic college, St. Michael's, undoubtedly because of its heavy use of the Scriptures.

I sought out the standard literature on Keynes seeking how the great Keynes had come so badly behind this self-taught man from beyond those Great Waters and high mountains. I reviewed works that I had not consulted for many decades. The work of D.E. Moggridge, a Cambridge economist particularly close to Keynes, but sufficiently independent to appraise him in all his strengths and weaknesses. Keynes' great gifts were handicapped by his social milieu. McGeer's encouraged the development of his highly independent mind.

Moggridge in his book *Keynes* (University of Toronto Press, Toronto and Buffalo, third edition) paints a picture of the academic society in which Keynes grew up and worked. His father, a distinguished economist and university official, was part of that formative setting. Keynes saved his most cutting criticism not for the "self-balancing market" prophets who were his teachers and colleagues, but for the politicians who negotiated the Peace of Versailles who were without an inkling of the transfer problems that could not be dealt with unless the Germans were allowed to earn the foreign currency by helping to reconstruct the damage they had wrecked in France and Belgium. But to fill his lungs with really fresh air, he relied largely on the Bloomsbury set of writers and painters, rather than on economists. But rather than risking a clean quick break with the economic school of Alfred Marshal, friend of his family and his own teacher, he just naturally watched his manners as a well-bred English lad should. He simply had to "ooze" out of the world of Marshall. And that does takes time. Unfortunately the world was kept waiting until Gerry McGeer came along. But instead of celebrating what he put on their law books his fellow countrymen have put him under wraps.

William Krehm

A Historic Brief to the Ontario Legislature

With the failure of our government to make use of the Bank of Canada for the purposes for which it was bought out in 1938, the resources that used to go into improved educational and social services have gone instead to redeeming our banks from their repeated gambling plays. Tiding of those connected with subprime mortgage debt have just begun pouring in.

So long as the nationally owned Bank of Canada financed much of the federal government's infrastructure projects – and on occasion those of provinces and municipalities as well – the net interest paid on such debt ended up as dividends to the Bank of Canada's sole shareholder, the central government. However since the latter 1980s, the bailout of our banks from their mammoth losses led to the increase of federal debt held by the private banks from 6% to 22%, of the GDP, at the same time that interest rates were pushed up to "lick inflation."

But what the government called "inflation" was in fact mostly the effect of the shift of government borrowing from the BoC, which had previously cost Ottawa nothing, to the private banks as the same time as interest rates were being pushed into the skies. That was the major factor in running up the debts of all levels of government. Since 1988 banks have been allowed to acquire debt of developed countries without a down payment, on the false ground that it was "risk-free." The rise of the price level was in great part due to the very shift of so much government debt from the central banks to the private banks. For this came from $80 billion of federal debt that the banks now came to hold, as compared to about $20 billion before 1988. But these very high rates that, after the end of the reserves are the only measure left to "fight inflation," actually contribute to it. The Bank of Canada pushed up interest rates to unprecedented levels, and thereby caused the price level to heave up still further. So the federal government to control the financial earthquake of its own creation downloaded onto the provinces social programs without adequate funds to pay for them, and the provinces passed on the compliment to the municipalities. That is why our hospitals have for the past decade and more been turning away patients, and bedded others in the corridors and cupboards. And the Mayor of Toronto has threatened to shut down a recently completed subway line. All this can be traced back to the deregulation of our banks.

And to cope with these emergencies, COMER, the Canadian Action Party and others are once organizing a push to use the Bank of Canada for the purposes for which it was nationalized in 1938 and made it possible to handle its costs for its part in WWII more efficiently than either the US or the UK, that had private central banks. A lot of effort on the part of many municipalities in both the US and Canada has gone into municipal initiatives for this goal.

To make our public aware of these past efforts of municipalities pretty well across the country we are grateful to André Marentette, of Lake Shore, Ontario, a suburb of Windsor. André has gone to the trouble of tracking down the record of the presentation to a Committee of the Legislative Assembly of Ontario commission on February 24, 1993, a group organized specifically to deal with the financial crisis that the bank bailout was beginning to produce among our municipalities.

Particularly noteworthy is the degree of access that groups questioning the policies of the Bank of Canada used to have to both federal and provincial governments. For years that has no longer been the case. Limitations of space make it necessary to cut the presentations. Of the three speakers cited, two, John H. Hotson, the head of the Committee of Monetary and Economic Reform and Harry Pope, professors respectively at Waterloo and Ryerson University have since passed away, but their work lives on to inspire us.

"Mr. André R. Marentette: I'm the chairman of Canadians for Constitutional Money. We are a non-partisan group promoting non-interest-bearing loans of government-created money."

Lures and Fictions of Deficit Problems

"Mr. John H. Hotson: I'm here to talk about the deficit problems that the Ontario government shares with so many other governments, and that is what the Canadians for Constitutional Money is all about.

"Deficit reduction is all the rage today, but few of our would-be deficit-cutters seem to consider is that cutting expenditures or raising taxes would make the present depression worse. The world did not end the Great Depression by balancing government budgets. The near-zero interest rates of the late 1930s, though helpful, could not induce sufficient private borrowing and spending to induce prosperity.

"Let us look back to what we learned from and then forgot from the Great Depression. The Depression was ended only when central governments all over the world drafted their central banks and forced them to create a flood of new money to finance massive government deficits at near-zero interest rates. These massive deficits, upwards of 25% of Gross National Product for several years, resulted in a real rise in private incomes and a great reduction in private indebtedness. It was this creative use of the powers of the powers of the central bank and the central government which made Canada in a few years an industrial power, and ushered in some 35 years of the greatest growth and employment levels in the history of capitalism, indeed of the history of the world.

"As I see it, the governments of Canada have broken three fundamental rules. These rules are:

"1. No sovereign government should ever under any circumstances borrow any money from a private bank.

"2. No Canadian federal, provincial or local government should borrow foreign money when there's excessive unemployment here.

"3. Governments, like businesses, should distinguish between capital and current expenditures, and when it is prudent to do so, finance capital improvements with money government has created for itself.

"In the rest of the time I have, I'll speak mainly about the first point. Professor William Henry Pope will speak on the second point. Mr. William Krehm will do the same for the third rule.

"Bad monetary policy and bad monetary institutions have caused the depression that now grips the world. But every crisis is also an opportunity. A most promising action plan has been developed out of COMER's deliberations. This is the Sovereignty loan petition to end the Depression created by Mr. Ken Bohnsack of Freeport, Illinois. It reads as follows: 'To promote the general welfare, we the people petition Congress to make interest-free loans of United States Treasury money to tax-supported bodies for voter-approved capital projects.'

"Some 1,371 tax-supported bodies, plus the US Conference of Mayors, with 1,050 members representing cities and towns where 80 million Americans live, have passed resolutions supporting the Sovereignty loan petition. So we can be confident that the enabling legislation will be introduced into this session of Congress.

"The Sovereignty loan plan has spread far beyond the US. I had the pleasure along with Professor Bob Blain of travelling through New Zealand for five weeks, spreading the word about the Sovereignty loan petition. If I had more time I would like to talk about New Zealand as the only democratic country on earth to get out of the Great Depression before the War forced the monetary expansion that brought about the end of the Depression everywhere else. They did it in exactly the same way as the Sovereignty loan petition proposes. So I was just telling them, 'Go back to what you did, before this "new right" stuff that got you into such trouble.'

"The Canadian organization to support the plan could not be called Sovereignty for obvious reasons having to do with Quebec separatism. That's a pity because Ontario's own Mackenzie King said it all. 'Without government creation of money, talk of sovereignty and democracy is futile.' André chose the name Canadians for Constitutional Money.

"A sovereign government like Canada reserves to itself the constitutional power to create legal money. Indeed, only government of Canada is legal money or legal tender just as it says on any Bank of Canada note. That's the only legal tender money we have."

Bank Money a Mere Promise to Pay Cash

"The bank money that is so much more prevalent today is merely a promise to pay legal tender But we have a very top-heavy situation now where there's very little legal tender in the country, very little spendable M1, they call it. And we're getting along with very high interest rates, very inefficient money substitutes, 'funny' moneys, including M2 and M3.

"The Bank of Canada has all the powers in the *Bank of Canada Act* necessary to carry out some Canadian version of the Sovereignty plan. I'll skip over the well-known passages of section 18 of the Act.

"By wise use of its powers from the day it opened its doors in 1935 through the end of the war in 1945, the Bank of Canada created almost 80% of the new money needed to end the Depression and win the war in 1945.

"What a contrast with the most recent period. In 1945 Canada's base money, or its legal money, was 68% of M1 and 27% of M3. By 1992 it was still 64% of M1 but only 8% of M3. The transaction balances had fallen from 40% of M3 to a mere 12%. It's because of the liquidity shortage, which the bank has caused, that interest rates have risen from their near zero rate in 1945 to the 1980s peak of over 20%, before falling to their present 6% or 8%. which is still high."

On other occasions John Hotson, allowed more time, would explain money spent into existence by the government of Canada for government purchases and paid for with paper money or bookkeeping entries meant that interest rates were largely kept out of our price structure. But chartered or commercial banks lend money – that they don't necessarily have – into existence so that it is birthed with interest incorporated into the price structure." And then when this arrangement causes a rise in prices to pay for the interest incorporated into the very money creation, the Bank of Canada has been pushing up interest rates still further to "lick inflation." Those higher prices were due largely by the substitution of government created money that is spent into existence without interest rates attached, and the huge increase of M3, which is part of the money lent into existence thus incorporating interest into costs and the price level. That in essence places speculative bank capital in the driver's seat and they go on pushing up this interest creating formula until it produces interest on interest two ever greater degree. Finally when the ever mounting process cannot continue, that leaves our governments with only military solutions to get out of the hopeless financial corner into which they have gotten themselves.

"I urge Ontario, the most powerful province in Confederation, to demand the federal government exercise its constitutional powers and compel the Bank of Canada to create meaningful sums of money and lend these sums at its wartime $^4/_{10}$ of 1% to 1% to the provinces and local governments to pay for new infrastructure programs such as Toronto's new subway, etc., that we need to deal with our unemployed and with our infrastructure, educational and environmental deficits.

"Mr. William Henry Pope: The notion that Canada must borrow abroad to finance the current account deficit is to get it precisely backwards. Without a current account deficit (more Canadian dollars supplied than demanded because of current account transaction) the importers of capital would be quite unable to effect their capital imports by turning their foreign currency into Canadian dollars.

"The way it works, I'll explain. The inflow of foreign money on capital account or our foreign borrowing – the $3 billion, the government of Ontario borrowed abroad earlier this year – increases the demand for the Canadian dollar. Anything that increases the demand for something pushes up its price and in proportion lowers the price of foreign currencies to Canadians. That is why Canadians wish to increase their imports, and to do so exchange their Canadian dollars for the now cheaper foreign currencies that came in on the capital account. Thus the capital account surplus causes the current account deficit.

"Nothing could be better for Canada than that foreigners should take out every bloody cent they ever lent us and then the dollar would drop, and that's the best thing that could happen to Canada. Of course, it would make it more costly to go abroad, and imports would increase in price, but that's simply something that's in the system. We've been so unproductive for so many years because of the high rate of interest, the sooner the dollar drops the better."

"Mr. William Krehm: The distinction between capital and current spending is ignored in the accountancy of the Ontario government and of the federal government and at least most of the other provinces. When any of these governments puts up or buys a building, or acquires machinery that will last decades, it is written off entirely in the year of its acquisition and carried on the government's books thereafter at a token dollar. However, the debt contracted to pay for the acquisition is carefully amortized more or less over the useful life of the asset acquired. A whole line of auditors general recommended that capital budgeting, also known as 'accrual accountancy' be adopted by these governments. The United Nations has made the same recommendation internationally, but nothing has been done about it. If you tried running a private corporation on that basis, it would be bankrupt from day one. It couldn't raise a dollar in capital.

"Professor Hotson has emphasized how the war and the subsequent peace were won by the central bank making available to the government its money-creating powers. You will find all the provisions that made this possible in the *Bank of Canada Act*, rather like a dinosaur's tooth, remarkable for the fact that it's enormously big, but hasn't been used for chewing anything for aeons.

"The fair and logical way of financing the Ontario government's capital projects would be for the Bank of Canada to use article 18 of the *Bank of Canada Act* to lend to the Ontario government directly. That would not be 'inflationary.' but on the contrary anti-inflationary, since it would keep interest out of the costs of the provinces projects and hence reduce the taxation as well as interest rates entering price. Moreover, by adopting accrual accountancy – also known as capital budgeting on top of that the government would have several distinct factors keeping the price level lower. There remains a detail, to note, however. Since the provincial government is not a shareholder of the Bank of Canada, the interest paid to the Bank of Canada by the province to it would not return to it as dividends. It would go to the federal government instead. But since under the present system, much of the growing fiscal problem can be traced to the federal government down-loading social and infrastructural problems to the problems, because it had blown its wad bailing out our gaming banks for the second or third times in as couple of decades, the province would have a powerful case for negotiating an arrangement whereby the federal government would pass on the equivalent of the provincial government's interest paid to the Bank of Canada for its loans that reached it in its dividend payment. This would introduce a missing degree of harmony between all levels of government, since the provinces have downloaded social programs to the municipalities just as the federal government did to it, without the funds to take care of them.

"But once you break the conspiracy of silence about how we have been financing our governments' capital projects at all levels, you will have countless ways of arranging our affairs more sensibly and economically. We did so during World War II, and we could do so today while underpinning peace and well-being in the world. Not the least of these is introducing serious accountancy at all levels of government. I am talking about double-entry bookkeeping. Without it accountancy, and democracy itself, is a fraud.

"It's long been the practice of all Ontario governments, be they Tory, Liberal or NDP, after a budget is brought down, to send a civil servant to Boston to explain to the bond-rating people that the deficit is really not a deficit, because what has been written off as a current expense is a capital investment that will last for decades. But why in the name of the Lord should the people of this province not be given the key information to the bond-rating folk in Boston?"■

Politics, Not Technology, Is the Main Problem in the Energy Crisis

Within days of each other news on two diverse fronts in Brazil and Canada indicate that solutions for our living in peace with our environment are technologically possible. What is impeding progress to meet critical environmental deadlines are political and social barriers.

One of these has to do with the production of ethanol which traps energy from sunlight in plants and transforms it into ethanol. In Brazil the sun is far warmer and sufficient land is available to grow the sugar cane at low enough labour costs, to make the resulting ethanol available at costs and in decisive quantities. There no matter whether oil prices may be up and down, the problem is entirely political.

The Wall Street Journal (09/10, "Ethanol Giants Struggle to Crack Brazil Market" by Antonio Regalado and Grace Fan) tells of the seemingly star-crossed Brazilian ethanol promise as a solution of the oil crisis in vast global areas: "Ribeirao Preto, Brazil – Nowadays plenty of investors want to talk to Cicero Jonqueiro Franco. Together with two sons and numerous cousins, he controls a great deal of something the world wants: ethanol.

"Mr. Jonqueira Franco, a founder of Companhia Acucareira Vale de Rosario, a steam-belching mill that crunches sugar cane into sugar and ethanol, has received offers from several suitors. These include a $775 million bid for his company from New York based commodities giant Bunge Ltd., but Mr. Jonqueiro Franco, whose family arrived in Brazil in the 1700s and still owns prime tracts of sugar cane land in Sao Paolo state he says he'll never sell.

"Thanks to high oil prices and worries over global warming, multinational companies are straining to find ways into Brazil's booming market for biofuels – i.e., renewable fuels made from crops such as corn and sugar cane. The US and other countries hope to substitute as much as 15% of domestic gasoline for ethanol over the next decade. With ample land, low production costs and ethanol production experience, Brazil is viewed by many as the country best able to sate world demand. Commodities giants, hedge funds, and energy companies have descended here as potential investors. But these are colliding with an earthy reality: families that have controlled Brazil's sugar-cane wealth for decades and even centuries. Many don't want to sell; others are asking sky-high prices for operations riddled with problems.

"The standoff is preventing some big foreign players from getting into Brazil's promising ethanol market through acquisitions and forcing them to develop their own projects from scratch. Yet resistance to outsiders could affect how quickly larger amounts of cheap Brazilian ethanol can begin flowing into the world's auto fleet. Big companies which have better access to credit and capital could help develop and modernize Brazil's ethanol industry."

Brazil's Heirloom Lands are Not Readily Bought

"Archer Daniels Midland Company, the largest US ethanol producer, has been shopping here for more than three years. Global sugar traders such as Australia's and Germany's Suedzucker. All have met with high prices and lengthy negotiations. India's largest sugar and ethanol maker, Bajaj Hindusthan Ltd. announced plans a year ago to spend $500 million to acquire mills, but have struck out. The domestic sugar and ethanol industry is informally managed and highly fragmented, making it less than ideal for outside investment. Often, millers don't have reliable accounting books, and are plagued by tax disputes and debts. Slow court decisions accentuate the problems.

"Labour and environmental pitfalls also loom for outsiders. Most sugar cane is still cut by hand – gruelling work that has enriched landowners for centuries, but could expose foreign owners to liabilities. Global bank HSBC Holdings PLC got unwelcome publicity for loans it had made to Para Pastorile Agricola SA, a mill in the state of Para that was raided by a government anti-slavery task force earlier this year.

"Brazil's mill-owners face some political pressure not to sell. If foreigners or large companies gain leverage Brazilians stand to gain less from an ethanol boom. Despite the many hurdles, foreign biofuel companies such as ADM believe that getting into Brazil is still a must. US corn ethanol which is less efficient to make, has been competitive with gasoline due to a 51-cent tax on each gallon. And both ADM and Cargill Inc. faced narrowing profits in their US operations last year due to leaping corn prices – as side effect of greater demand for corn from ethanol producers.

"By contrast Brazil's sugarcane ethanol can comfortably compete with costly oil – even if oil trades in the low $40s per barrel range. ADM's CEO Patricia Woertz says she believes Brazilian ethanol operations would provide 'an opportunity for profitable growth no matter what happens in the US market.' Although a stiff US import tariff of more than 50 cents per gallon makes Brazilian ethanol costly to import into the US, Brazilian ethanol could dominates other markets in Asia or Europe."

Brazil simply has better access to the energy of the sun than most other parts of the world. And that is certainly no small thing both for Brazil and through it with the rest of our planet.

"Analysts say that Brazil needs billions of dollars in investment to expand production and the pipelines and other infrastructure to become the world's supplier of ethanol. There are roughly 210 companies running 368 sugar and ethanol mills. The five largest players generated about 17% of the country's ethanol last year.

"In the US, where ethanol is made from corn, any company can build a refinery and buy corn on the open market. But because sugar cane's heft makes it costly to transport, and its sucrose content degrades quickly, crops are always planted close to the mills that process them. That makes it difficult to sidestep people like Mr. Jonqueira Franco, who owns 3,200 acres of prime plantation land.

"Sugar barons' control over the ethanol industry could impede Brazil's effort to create a global market for ethanol. Japan, for instance, has been in talks with Brazil since 2001 to sign a long – term ethanol contract. But the Japanese officials have wavered, expressing concerns whether Brazil's sugar families can furnish steady supplies of ethanol. In the 1980s, local producers chasing high sugar prices created an ethanol shortage that left Brazilian drivers of all-ethanol cars without fuel. Having large companies focused largely on ethanol rather than sugar could help prevent future supply shocks.

"Brazil has been using ethanol since the 1970s when the government decided to support the fuel to lessen its dependence on Mid-Eastern oil. Over the decades the vast country has managed to gradually reduce the cost of making the fuel, but gasoline was so cheap in the 1990s that the effort almost died. When oil prices began their steady climb in 2002, however, sugar-cane ethanol became cheaper than gasoline. Ethanol is also gaining followers because it contributes less to global warming than gasoline. While burning either fuel produces similar amounts of carbon dioxide a greenhouse gas, ethanol crops such as *sugar-cane reabsorb the carbon dioxide when they are grown – something that has no equivalent in the case of mineral oil*.

"Some foreign investors have decided to create new cane plantations, or 'green fields' far from Sao Paolo state where Brazil's powerful sugar cane families dominate. Investor George Soros and Texas hedge fund HBK group are plowing more than one billion dollars into such efforts, as is Brazilian Renewable Energy Co., or Brenco, a start-up backed by US billionaire Ron Burkle and venture capitalist Vinod Khosi."

W.K.

Disentangling a Knotted World

So impassioned and promoted has our drive become to understand the hidden secrets of our world, that we are increasingly coming to overlook the difference between belief and certainty. Then all that remains is to falsify the weights and measures in ways that transform narrow self interest into greater truths against the lingo and formalities of science and we are well embarked, to our self-destruction.

This came to my mind on finding on opposite columns of the Marketplace section of *The Wall Street Journal's* that seem a desperate attempt to question two supposed poles of certainty – our science and our insurance industry. Surely that takes us a long way from questioning what President Bush may be presenting as gospel at any particular moment.

The first under the heading of "Most Science Studies Appear to be Tainted by Sloppy Analysis" brings troubling questions into the very temple. Let us refer to them separately in turn: "*Science Journal*, 'Most Science Studies Appear to Be Tainted by Sloppy Analysis': We all make mistakes and, if you believe medical scholar John Joannidis, scientists make more than their fair share. By his calculations, most published research findings are wrong.

"Dr. Joannidis is an epidemiologist who studies research method at the University Joannina School of Medicine in Greece and Tufts University in Medford, Mass. In a series of influential analytical reports, he has documented in thousand of peer-reviewed research papers published every year there may be more than meets the eye. These flawed findings, for the most part, stem not from fraud or formal misconduct, but from more mundane misbehaviour: miscalculation, poor study design, or self-serving data analysis. There is an increasing concern that in modern research, false findings may be even the majority, or the vast majority of published research claims. Dr. Joannidis said. A new claim about a research finding is more likely to be false than true.

"'The hotter the field of research, the more likely its published findings should be viewed skeptically,' he determined.

"Take the discovery that the risk of disease may vary between men and women, depending on their genes. Studies have prominently reported such sex differences for hypertension, schizophrenia, and multiple sclerosis, as well as lung cancer and heart attacks. In research published last month in the Journal of the American Medical Association, Dr. Joannidis said his colleagues analyzed and published the research claims concerning gender and genes.

"Under closer scrutiny, almost none of them held up. Only one was replicated."

"Statistically speaking, society suffers from an excess of significance.

"Overeager researchers often tinker with the statistical variables of their analysis to coax any meaningful insight from their data. In the US research if a $55-billion-a-year enterprise that stakes its credibility on the reliability of evidence and the work of Dr. Joannidis strikes a raw nerve. In fact, his 2005 essay "Why Most Published Research Findings Are False" remains the most downloaded technical journal PloS Medicine has ever published.

"'He has done systematic looks at the published literature and empirically shown us what we know deep inside our heart, said Mouin Khoury, director of the National Office of Health Genomics at the US Center of Disease Control and Prevention. 'We need to pay more attention to the replication of published scientific results.'

"Every new fact discovered through experimentation represent a foothold in the unknown. In a wilderness of knowledge. it can be difficult to distinguish error from fraud, sloppiness from deception, eagerness from greed, increasingly scientific conviction from partisan passion. As scientific findings become fodder for political policy wars over matters from stem cell research to global warming, even trivial errors and corrections can have larger consequences.

"Still other researchers warn not to fear all mistakes. Error is as part of science as discovery. It is the inevitable by-product for the search for truth that must proceed by trial and error. To root out mistakes, scientists rely on each other to be vigilant. Even so findings are rarely checked by others or independently replicated. Retractions, while more common, are still relatively infrequent. Findings that have been refuted can linger on in the literature for years to be unwittingly cited by other researchers, compounding the errors.

"Stung by frauds in physics, biology and medicine, research journals recently adopted more stringent safeguards to protect at least against deliberate fabrication of data. But it is hard to admit even honest error. Last month the Chinese government proposed a new law to allow scientists to admit failures without penalty. Next week, the first world congress on research integrity convenes in Lisbon.

"On average researchers submit about 12,000 papers annually just to the weekly peer-reviewed journal *Science.* Last year, four papers in the publication were retracted. A dozen others were corrected.

"No one actually knows how many incorrect research reports remain unchallenged.

"Earlier this year informatics expert Murat Cokol and his colleagues at Columbia University sorted through 9.4 million research papers at the US National Library of Medicine published from 1950 through 2004 in 4,000 journals. By raw count just 596 had been formally retracted, Dr. Cokol reported.

"'The correction isn't the ultimate truth either,' said Prof. Kevles."

Now, we would propose that the reader step back several paces to compare this with the state of affairs in economic theory and the economic faculties of the world's universities, and the world's libraries. There it is not the difficulty of the subject that leads to honest or careless error. What is at stake is not an objective truth, but the political power and economic privilege. Here the problem is not that the official model gets roughed up unjustly by many who get published, but no matter how long and how well the suppressed views may have been proved correct, or highly useful to society, with a change of political power and a new economic coming into control, any challenge of their economic model, in the libraries, in our universities or the media, are purged of anything that challenges the model enthroned. What we would give for such a sorting out of obvious error with what was proved correct and useful over decades of our history. Cleo, Goddess of History, simply has had her eyes torn out and she wanders about distraught in complete darkness.

W.K.

Gospel for Year One of RM (Risk Management)

Should our epoch be changed from A.D. (Anno Domini) to RM (Risk Management) for Risk raised to a higher mystique? That would seem to be our new Lord from whom under the new doxology all the supreme reward and punishment are deemed to flow.

I would not trust myself as a perennial doubter with the exact formulation of the new evangel. So I will go to the column "Long & Short" of Jesse Eisinger (*The Wall Street Journal*, 22/3/06, "Intrepid Debt Investors Turn Up Risk, But Much Hinges on Lasting Stability"): "Let no one claim that we were not forewarned – even by Wall Street's own paper.

"Debt investors expect prices in the market to be stable and returns to be meagre for as far as the eye can see.

"So they are coming to a natural conclusion: it is time to borrow more money and make riskier bets. That type of thinking is often dangerous.

"Investors make these bets mainly through esoteric products designed by Wall Street math whizzes to spread the risk of owning debt. Those products bundle bunches of loans and slice them up into less risky and more-risky sections sold to investors.

"The problem is that nobody knows just how much the few investors who buy the riskiest portions stand to lose if things go badly. These are folks who bet, say, $1 million and stand to gain $10 million – or lose $5 million or so. Such highly leveraged bets are being taken in products that lack transparency. Nobody known how much is at risk in the entire market if there is a big blow-up."

I know you were wondering about the matter – this is where the new faith comes in. It is a faith not in the Lord but in a "self-balancing market" that solves all problems if just left alone, unrestricted by governments, tax-collectors or whatever. That "whatever" includes economic production. You will note that the slicing of debt, real or hypothetical, is fast becoming the main "product" of our one super-power, while production of directly useful items for human survival is being outsourced to Asia and Latin America.

Then comes the Evil One whispering into the ear of the man of faith: "Why investors are so confident the markets will be placid is a troubling puzzle. The optimism seem misplaced. It is unclear when the Fed will stop raising rates. And the bond market – where long-term rates have been incongruously lower than short-term rates – is forecasting an economic slowdown that few believe is really coming.

"That suggests that debt-market are facing a rocky road. Yet investors are becoming more confident that prices will have fewer sharp moves up or down than in the past. Merrill Lynch's index for measuring expectations of bond-market volatility fell below its all-time lows at the end of February."

"The previous low was set in July 1998. Two months after that bout of optimism the "Long-Term Capital Management crisis hit and the index – along with global financial markets – went hay-wire. These confident investors could be making a mistake. Right now, the consensus expects the Fed to stop raising short-term rates soon, and that long-term rates will rise – a return to normalcy. But that probably conflicts with their expectation that markets will remain stable, since big changes in interest rates are rarely smooth.

"Despite this, the mood is sanguine and the esoteric market for complex debt products is booming. There were 225 non-bank investors active in these esoteric markets at the end of last year, up from 170 a year earlier, says Steve Miller, who keeps the data for Standard & Poor's. Most of the newbies: risk-loving hedge funds.

"Take a look at one section of this market: bank loans to companies that are bundled and sold in pieces that are ranked from least risky to most. The growth of this collateralized-loan-obligation market exploded last year. Morgan Stanley reckons the total value of new CLOs more than doubled to $66.7 billion in 2005 from $31.9 billion in 2004.

"With demand so high, it is a sellers' market, and the interest rate that investors are getting continues to fall. Right now, a medium-risk investor would get 1.7% percentage-point more than the going short-term rate, which is near historical lows. But if investors think prices are stable, and therefore that such low returns are at least safe, they will feel secure in taking on even more risk. The result: people are talking themselves into deals now that they wouldn't talk themselves into a few years ago, market observers say.

"The CLO structure magnifies the risk for certain investors: The holders of the most risky slice – the so-called equity tranche – are on the book for the big hit if just a small portion of the underlying loans goes bad. So the numbers of loans that go bad must stay low and predictable for the investors in the riskiest slices to continue making oodles of money. So who is holding the riskiest tranches? It is mostly hedge funds. As smart, nimble investors, they are the logical holders of the risk. However, this group is also the most aggressive and the most in need of continued short-term performance. How much underlying 'leverage' do they all really have? Nobody really knows because nobody keeps track."

That is where faith comes in to the point of renaming our epoch.

"The cocktail is equal parts low returns, more leverage and equal transparency. As the Fed keeps raising rates, the markets surprisingly don't seem to be worried about the hangover."

They promised us miracles if we only cut taxes for the very rich and slashed wages and employment at home to make this possible. And come to realize it, the economy is actually walking on water!

W.K.

A Monarch Currency in Need of Crutches

From a friend I have received the copy of chapter of a new book about to be published by WND Books, *The Late Great USA – The Coming Merger with Mexico and Canada* by Jerome R. Corsi. The chapter in question is entitled the "amero" which is the common currency apparently to replace the three current currencies of these lands.

"However, rather than embrace 'dollarization' – the practice already occurring in many Latin American nations of adopting the US dollar as the country's currency – globalist scholars argue that a new currency, the *amero,* must be created. Even before 2002, when the euro was finally adopted by a number of the European Union countries, academics in the US and Canada were actively discussing the need to create a North American Monetary Union."

It was not a faith that lived or died quietly. Originally it attracted both those of the left who are temperamentally drawn to anything that can be presented as a lowering the barriers between nation and nation. But some second thoughts surfaced among some of these after a while as they recognized that there was more behind this initiative, than the hope for a more united and hence presumably a peaceful world. Even the rightist Fraser Institute in Canada which was in the driver's seat in most rightist initiatives retired after a while from its position for a common currency with the US. But whether because such a position was not injurious to academic careers or due to a sheer ignorance of Canadian and American history, the united currency movement has persisted, giving ample suggestion of being amply funded.

A new development has been the appearance of a decidedly rightist movement in the US in opposition to it, of which the Corsi book – of which we have seen only a single chapter – is an outstanding sample. It gives a thumb-sketch of both an American and a Canadian leader in the pro-Amero movement.

"Economist Herbert G. Grubel of the Simon Fraser Institute in Vancouver coined the term 'amero' and has led economic thinking about the advantages of a unified North American currency. He was a Reform Party member of Parliament in Ottawa for Capilano-Howe Sound from 1993-7. In a 1999 paper entitled 'The Case for the Amero: The Economics and Politics of a North American Union,' he argued that the innovation would not necessarily erode national sovereignty. He suggested printing the new currency with the amero symbol on one side and the national emblems on the other."

If only that were enough to keep us out of Washington's world adventures, or beyond the reached of the Federal Reserve's at times ham-handed monetary inspirations!

"The amero, however, would have its own value on foreign exchange markets, after the three countries converted their currencies into the amero at rates that leave unchanged each currency's income, wealth, and international competitiveness at the time of the conversion."

A Way of Ending Unemployment Among Economists

That in itself would go far to create full employment amongst economists and statisticians merely arguing what these reassuring phrases might mean.

That is not atypical of the propaganda for a common currency of one sort or another between Canada and her southern neighbour. A couple of years ago when the Bank of Montreal espoused a common currency – it is involved in 9% of the banking in the Chicago district alone – its lady chief economist explained to an audience of "favoured clients" the advantages of a common currency as seen from her lofty post: "It has made it so much easier the payment of her son's bills at the school that he is attending in Europe."

Building walls between the US and its prospective partner to the south, and possibly – who knows – putting walls or at least passports between Americans and those neighbours to their north is not invariably endearing to the idea of Canadians becoming absorbed in the cultural, monetary and military entanglements in a world that is increasingly turning to ultimate military solutions.

There is nothing, of course, against temporary cooperation with democratically rightist groups where the immediate goals happen to coincide with yours, but this warning is ever in place. Our goals have their roots deeply embodied in history. Most other groups – particularly rightist ones – tend to deal with twigs on the spreading tree of causes. For example, in the chapter of the Corsi book that I have seen there is no suggestion the that the three-country currency unification was to an extent carried out in the form of NAFTA in the early 1990s. The result: it almost brought down the world monetary system. It had been busily promoted by Washington telling the Canadians that the Mexicans were falling over themselves to enter the NAFTA arrangement; and told the Mexicans that the Canadians were impatiently awaiting the application of the proposal. That Mexico entered such an arrangement can only be explained by the detail that Mexico is far more corrupt than Canada. So – even though it had an infinitely more unfortunate experience with its Northern neighbour: the loss of half its territory to it and several invasions – it was the Mexicans who significantly went further than Canada. The Mexican governments even floated a bond issue – the *tesobonos* – that actually gave the holders the option of eventually being paid in US dollars even they may have bought the bonds with pesos.

It amounted to shorting the peso and bolstering the dollar in every such bond deal. And, of course, the border had become free for the movement of currencies. As a result the peso fell in value by some 40%. And that so alarmed Washington with its repercussions throughout the world, that President Clinton without even waiting for Congress's approval organized the greatest standby fund to that date – \$51 billion US – the US putting up \$51 billion, the IMF the same amount and Canada, \$1 billion. Even so there was a delayed echo of the disaster of this close harbinger of the united currency goal in the East Asian crisis and the Russian debt default a few years later. To this day Mexico has not recovered from partial currency unification experience. It contributed richly to the flock of Mexican immigrants, legal and illegal into the US, for hunger makes no distinction. And US employers apparently up to now have needed both.

And the wall that the US is building on its southern border provides the balance sheet of the partial experiments towards a common currency. To grope its way back to a serious peace, the world needs its history to guide it about what has never worked and cannot work. In Canada we need to apply the provisions of the *Bank of Canada Act*, for years entirely disregarded and violated by the government and our central bank. Without that history made accessible to Parliament, our universities and our media civilization, as we have known it, has scant chance of survival.

And the final wisdom with the slightest familiarity of the economic and monetary history of these countries by now too stale to occupy any serious student of the history of this land: "A US dollar collapse, if and when it occurs, will have been caused by mismanagement of the US economy by presidents and congresses over decades, both Democrats and Republicans alike.

"Our federal budget deficits reflects decades of passing orderly generous entitlement programs, beginning with the formation of the Social Security Administration by Franklin D. Roosevelt during the Depression of the 1930s. Now with the baby boomers retiring and with a US birth rate, finding future Social Security liabilities is a serious problem. Similarly, Medicare liabilities are intensifying as the government adds new programs for the prescription drugs program."

The author would have been advised to have studied the deregulation of the banks that had severely confined them to banking under the Roosevelt banking legislation, and specifically barred them from acquiring interests in the "non-banking pillars": the stock market brokerages, insurance and real estate mortgage companies. For the repeal of this legislation beginning with the 1970s gave them increasing access to just such other financial sectors. With that the cash reserves needed for the other "financial pillars" own businesses were taken over by the banks and used as cash base to which to apply the bank multiplier.

Bailing out the banks from their losses as a result of their takeover of the Savings and Loans in the 1980s led to the government absorbing losses of some $200 billion. By 1988 the Bank for International Settlements based in Switzerland, which served as a semi-underground centre where the world bank come-back to its 1929 freedom and glories, found it necessary to bring in its *Risk-Based Bank Capital Requirements* that declared the debt of developed countries "risk free" and hence requiring no down payment for banks to acquire. At the same time the BIS and the central bankers it dealt with had overlooked a crucial detail: when the banks load up with bonds entirely on credit and interest rates go up the market value of such debt hoards drops steeply. That is precisely what happened in 1934 to the $80 billion of debts held by Canada's banks – quadrupled since 1990. This matched throughout much of the world, threatened to bring down the international monetary system.

The largest safety backup was organized by the US, the IMF and Canada. Finally Washington realized that the days of sky-high interest rates were over. To get around that the US which had been writing of its physical capital investments – bridges, buildings roads, equipment while careful amortizing the debt incurred to build or acquire them finally brought in accrual accountancy, i.e., began amortizing a them as the private sector had done from time immemorial over their likely useful life. Though that was disguised as in the Department of Commerce statistics as "savings," that was no adequate description of them since savings implies cash or assets readily convertible into cash – these assets were buildings, roads bridges, bricks, mortar steel, and equipment. It was

Climbing the Derivative Ladder

As the world grows ever more resistant to the policies imposed on it from a few command centers, the distinction between fact and fiction is rapidly disappearing. Policies are being shaped less by their feasibility in handling society's problems than by whether they serve the rate of expansion predetermined by the replacement of growth rates – i.e., of "derivatives of higher degrees" rather than by the actual first-degree tables that are the basis of bookkeeping. To come up with growth rates, however, one must cast one's nets into the inscrutable future. History alone won't do. Hence it is the growth rates, and the rate of growth of the rate growth of the actual production, and so on to infinity that come to rule economists' reasoning.

That widens the gap between reality and the empowered fictions being reared.

The origins of the current acrobatics with derivatives is clear. It came into fashion in price theory, hardly by accident shortly after the Paris Commune (1871) when the labour theory of value (used by David Ricardo and Karl Marx) took the value of goods in a capitalist society to depend on the amount of average labour needed for the commodity's production. Or, alternatively, by the cost-of-production theory (John Stuart Mill).

Both of these located the site of value creation in the workshop, the "Satanic Mills" of the raw industrial revolution.

That was all right in the days of Ricardo when most English workers were still illiterate. But mechanics' institutes soon arose to teach workers to read, and what had been over their heads could soon be read by more of them to convey a dangerous angle of vision. Hence, the years after the bloody Paris Commune hailed by Marx from London as the precursor of proletarian revolution created the need for a new observation post for economic theory. From the workshop it was shifted to the counter where shoppers bought the merchandise. And here the value of the goods was seen as determined entirely by the balance of supply and demand – if demand outstripped supply, prices rose. If supply outstripped demand, it sank. What you may ask would determine the level of the constant remainder? The mathematical process of integration: by adding a constant number whenever performing the mathematical process for determining the new market price balancing supply and demand remains constant That constant, as indicated by the name, is not changed by bargaining between suppliers and demanders. Significantly there was no curiosity among any of the three different marginal utility theories of value that arose quite independently in three different countries at virtually the same time – Britain, France, and Austria.

But marginal utility value theory was baby stuff – it dealt only with the rate of growth or the first-degree derivatives. Basically it expressed the political dominance of the industrial capitalist. But with the triumph of the financial sector of capitalism, the evaluation of worth of shares, bonds, corporations, and the world was done in terms not of ordinary commodity prices, but in terms the rates of interest with which the drover – essentially the deregulated bankers – whipped the productive herds that included the industrialists into profitable obedience. Society thus ascended a further step on the derivative ladder.

This required the cleansing of our universities of everything that had been learned in the Depression of the Thirties, including that the banks had to be prevented from taking over the other "financial pillars" – stock brokers and insurance and real estate. For that we refer you to the article beginning on page 13 of this issue.

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enough to turn some 1.3 trillion dollars of assets of the federal government, which produced the positive balances that brought down interest rates, and created the plethora of cash that along with deregulation of the banks allowed them gamble their heads off and bring on the present subprime mortgage problem others that are just beginning to surface.

The weakness of the Corsi chapter is indicated by his having to go back to legislation of the Roosevelt era that with its sequel gave the world surcease from the prewar depression, financed the renovation of infrastructures of 16 years of depression and war, allowed the introduction of new technologies and the education of the younger population to education standards undreamt of before the war. It is the trillions lavished on bank bailouts as they lost more and more of their capital and were bailed out at the expense of the most defenceless members of society.

William Krehm

The Detail Governor Dodge Forgot

The Globe and Mail (15/10, "'We should have been driving rates harder,' Dodge says of Credit Crunch") carries a small but astounding article from Reuters News Agency: "Bank of Canada Governor David Dodge said he should have driven up interest rates 'harder' before the current credit squeeze to tighten borrowing conditions, according to an interview published in *The Economist* magazine.

"In a mea culpa to financial markets, he said the central bank may have played a role in fomenting excesses in credit markets prior to the disruption rising from defaults on payments by US subprime mortgage holders.

"In an interview published on the magazine's website he said, 'One can see in retrospect that we should have been driving these rates harder than we did because in reality credit conditions were being eased by increased securitization and movement of stuff off balance [sheets].'

"Mr. Dodge was also outspoken in an interview with *The Financial Times* of London yesterday. 'The European Central Bank's efforts to restore confidence to markets by pumping in liquidity are unlikely to succeed,' he said. 'I'm not sure practically, whether it would do anything. If I thought that somehow there was a magic wand and we did that for three or four days, and that all of a sudden the markets would clear, and life would be beautiful.... There is no principle that says that is a bad thing to do. but I can't believe that it will do the job.'

"Mr. Dodge also criticized credit rating agencies who gave top credit ratings to highly structured products without explaining all the attendant risks. 'I won't let the credit rating agencies totally off the hook. They didn't work terribly hard to make sure people understood their ideas,' he said."

The most gentle remark in response to the Governor's wisdom, is that he, too, has not overworked learning about what happened to the international financial system when Washington conned Mexico and Canada into NAFTA. Mexican politicians, considerably more corrupt than some of our own, not only removed the established restrictions on foreign currency leaving the country, but issued special bonds – the so-called *tesobonos* – that could be bought for pesos but gave the buyer the option of having them repaid in US dollars when due. In essence to please the Yanks Mexican government sold their own currency short. What a tip off for currency speculators! Meanwhile the frontier had been opened wide as far as foreign currency was concerned. As a result the Mexican economy collapsed with the peso losing some 40% of its value. Foreign currency was sent abroad in torrents by those with advance information of the arrangement.

Mexico's Epic Nationalism Sold Short

The Mexican banks which had been privatized not long before after a period of nationalization during which the government got them out of their debt, had to be nationalized all over again. Eventually, 85% of them ended up under foreign control. The standard of living in Mexico collapsed, and a new financial group of stock brokers replaced the banks even in marketing government bond issues by TV auctions. It is largely because of that experience that the armies of unemployed began crossing the American frontier with and without visas.

The Mexican financial crisis, moreover, threatened to spread abroad and bring down the world monetary system.

There was a further factor in this crisis of which no Governor of a central bank can be unaware. The great Depression of the 1930s had been brought on by the Wall Street crash of 1929. And that had happened because the banks had been permitted to acquire control of the other "financial pillars" – stock brokerages, insurance and mortgage companies. That is why President Franklin Roosevelt when he was first inaugurated in 1933, faced with 38% of the banks in the land closing their doors, declared a bank moratorium and extended it when it ran out. And then he passed new banking legislation that prevented the banks from acquiring interests in those other "financial pillars." The reason was that when banks get their hands on the liquidity reserves that those other "financial pillars" keep for the needs of their own businesses they use them as money base for applying the "bank multiplier." The latter is the very essence of banking, the banks' ability to lend out far more than the cash they hold.

So long s they can honour all claims on the money left with them, all goes well. Should they fall down, however, in honouring the claim of a single client, a run on the entire banking system is likely to ensue. That was a principal factor in bringing on the crisis of the 1930s. That is why the Roosevelt Banking Laws that were shortly after brought in along with insurance for bank deposits, explicity forbade banks stepping outside banking and taking over the other "financial pillars." However, after the war and years of keeping the nose of the banks strictly to banking in the US and throughout the Western world, the banks prospered once more and started yearning for the old fleshpots of the 1920s. And because of that, beginning in the latter 1960s in a serious way the US banks were deregulated and globalized. In the 1980s they took over the Savings and Loans in the US – essentially mortgage associations – and soon ended up subdividing land for housing in the Arizona desert. Eventually the Government took over many of them paid out their bad debts and sold them at an almost quarter billion dollar loss to healthier banks.

That, however, only made the government an accomplice of the banks in their push for picking up the trail as of 1929 when they had brought down the entire economy for a decade until the World War.

Coming to the rescue of the world banks

as well, was the Bank for International Settlement, (BIS) a sort of central bankers' club based in Switzerland. To help the American and world banks out of their non-banking losses, BIS in 1988 brought in its *Risk-based Bank Capital Requirements* that declared the debt of developed countries "risk free" and hence requiring no down payment for banks to acquire. In this and other such ways the banks were allowed to replace their lost capital by clipping the coupons of the massive bonds they were able to acquire entirely on the cuff – no money down.

The BIS as Low-profile War Room for Banks' International Comeback

Now the key detail of this hushed-up tale. When a central bank holds government debt, whether the central bank is privately owned or nationalized as the Bank of Canada was, the interest paid on those bonds comes back – substantially – to the government as dividends. In the case of privately owned central banks like the US Federal Reserve System, the justification of those remittances of the Fed's profits to the government is, historically, the ancestral sovereign's monopoly in coining and recoining with less metal content nation's money. Since 1971 the world has gone off the gold standard and there is nothing other than government credit behind the paper bills and the bookkeeping entries of the central bank. For these are the only legal tender. It must be accepted by law in payment of any debt over some trifling amount otherwise the debt is no longer valid. No banker, and certainly no central banker could possibly be unacquainted with this stretch of our banking history. However, it is not considered fit to be shared with the public that has paid the immense cost of what was not only a bank bail-out but of further deregulation which would involve an enhancement of the ability of our banks to gamble bigger if not better.

In Canada the federal government debt between 1988 and 1992, had risen from some $20 billion to $80 billion. And at the same time the Bank for International Settlements had urged the central banks throughout the world to push interest rates to the skies, to achieve what they chose to call "zero inflation."

And here is what Governor Dodge completely forgot in his expressing his regrets for not having pushed interest rates higher. He simply didn't dare to. For the government bonds that the banks had loaded up with to replace their capital lost in their gambles, would have come crashing as soon as interest rates ere pushed much higher. For with new bonds sold at par, the older ones with a higher coupon would tumble in market price. The banks would, as a result, be at risk again.

And that resulted in a positive innovation that no central bank head should not be allowed to forget. Up to that point no government – with the temporary exception of Denmark and Sweden, when it

Globalization's Poisonous Gas Balloon

At both the US and Chinese ends of the phenomenon the warnings go on mounting.

The Wall Street Journal (22/8, "China Pays Steep Price as Textile Exports Boom" by Jane Spencer) reports: Dongguan, China – Last summer Chinese government investigators crawled through a hole in the concrete wall that surrounds the Fuan Textiles mill in southern China in a surprise inspection of the plant. What they found caused alarm at dozens American retailers, including Wal-Mart Stores Inc., Land's End Inc., and Nike Inc. that use the company's fabric in their clothes.

"Villagers have complained that the factory, majority-owned by Hong Kong-based Fountain Set Holdings Ltd. had turned their river-water dark-red. Authorities discovered a pipe buried beneath the factory floor that was dumping roughly 22,000 tons of water contaminated from its dyeing operations each day into a nearby river, according to local environmental officials.

"In the two decades since US companies began turning to Chinese factories to churn out cheap T-shirts, jeans and sneakers that millions of Americans wear daily, China's air, land and water have paid a heavy price."

The clouds of smog that comes from the Pacific to blanket Los Angeles have received no lack of attention from the US press. What has not reached the American public so soon or steadily, is that in a very relevant sense it is just coming home. For without the Globalization and Deregulation push out of the US, it could never have happened.

"China has faced harsh criticism in recent months over the safety of exports ranging from tainted tooth-paste to toxic toys. But environmental activists and the Chinese government are increasingly pointing to the flip side: the role multinational companies play in China's growing pollution by demanding ever lower prices for Chinese products.

"Prices on fabric and clothing imported to the US have fallen 25% since 1995, partly due to the downward pressure brought by discount retail chains. One way Chinese factories have kept costs down is by dumping waste water directly into rivers. Treating contaminated water costs upwards of about 13 cents a metric ton, so large factories save hundreds of thousands of dollars a year sending waste water into rivers in violation of China's water-pollution laws.

"'Prices in the US are artificially low,' says Andy Xie, former chief economist for Morgan Stanley, Asia, who now works independently. 'You're not paying the costs of pollution. And that is why China is an environmental catastrophe. That is one reason why many of the country's biggest rivers resemble open sewers and 300 million people lack clean drinking water. Now. US retailers are scrambling to prevent environmental issues from creating the same sort of consumer backlash as the anti-sweatshop campaigns of the past decade.

"'After labor issues, the environment is the new frontier,' says Daryle Brown, vice-president for ethics and compliance at Liz Clairborne Inc. which uses Fountain Set cotton in some of its products. 'We certainly don't want to be associated with a company that's polluting the waters.'

"The textile industry is one of China's dirtiest. In addition to heavy metals and various carcinogens, fabric dyes may contain high levels of organic materials, and thread is often dipped in starch before it is woven into fabric. The breakdown of large amounts of organic compounds such as starch can suck all the oxygen out of a river, killing fish and turning the water into a stagnant sludge.

"Fountain Set's 230-acre Dongguan Fuan Textiles factory campus here sends a huge volume of textile fabric to American closets. The company is the largest knit manufacturer in the world, and its factories are responsible for about 6% of the global supply of knit cotton, according to Eddie Lau, an analyst at City Inc. in Hong Kong."■

made an investment, that would last even for many decades, treated it no differently than the soap in the wash-rooms of its buildings. It wrote it off in a single year and in year two recorded their existence only by assigning the value of $1 on the assets side of the government ledger to inform its auditors it had simply forgotten about the investment. But on the debit side the debt incurred to pay for the investment was carefully amortized over decades, which would more or less correspond to the natural usefulness of the asset. That had a series of unhelpful results: such accountancy breached the principal of double-entry bookkeeping, and led to far more taxation being collected than accountancy would require. That was not "inflation," which was used as a pretext for raising interest rates, but simply bad bookkeeping that could land a private business executive in jail for tax evasion. Here it was the taxpayers and consumers in general who were being deprived in order to replenish the banks' gambling funds. That in turn left a deficit that was not necessarily there, a powerful pretext for slashing social programs.

And now that President Clinton realized that this could not go on without bankrupting the entire world financial system, he brought in what his auditors – as had those of Canada and a Royal Commission two decades earlier had been urging for years, to no avail. But Clinton was too keen a politico to antagonize the folks who can contribute so generously to election financing – the bankers. So when the immense job of redoing the books was done and the process carried back to 1959, and some 1.3 trillion dollars of assets discovered, they were called in the Secretary of Commerce's figures beginning with January, 1996, "Savings" instead of "Physical Assets."

"Savings," however, is used by economists to refer to highly liquid assets – legal tender or cash, or financial assets of the highest quality readily convertible into cash. And here we are talking about buildings that may be a half century old with the site beneath going on ever appreciating, or bridges, highways.

Governor Dodge's Master Gaffe

Nor is that the end for Governor Dodge's incredible gaffe. In the 1960s an economist on the University of Chicago staff was awarded the so-called Nobel Prize for Economics of the Bank of Sweden for his paper recognizing investment in human capital – education, skills, and hence care of the vessels where these are held – health, and social services as the most productive investments that a government could make. He reached that conclusion because two decades before he and many hundreds of young economists who had been sent by Washington to Germany and Japan to predict how long it would be before those two defeated powers would be able to reconstruct their countries to have them reappear as formidable competitors on world markets. Two decades later Schultz wrote that it was amazing how wide of the mark he and his co-workers had been in exaggerating what the delay would be. He attributed this to their having concentrated on physical destruction, while ignoring that their exceptionally educated and skilled labour force had come out of the war intact.

It is amazing how much vital information about the world, its economy, its monetary and political systems, that Governor Dodge can avoid.

William Krehm

The Great Inflation Mystery Still Unsolved

In a special section of its 23/09 issue headed "Soapbox" – certainly a sign of the times – under the heading "The Great Inflation Mystery, Still Unsolved by Lawyer, Actor, Writer and Economist," *The New York Times* tries shedding light into the general darkness.

My first point: economics is an extremely inexact science. The more economists try to doctor it up with formulas, the clearer it is that the more we try doctoring it up with formulas, the clearer it is that we know very little about what causes great economic events. In particular we do not know what causes inflation.

"For a while we thought it was 'cost push'.... Then we thought it was 'demand push' – i.e., no aggregate cost increases of certain goods and services but demand push exceeding by far available supply."

But Mr. Stein misses another possibility – the price level can go up not for any single reason but by a variety of causes, not all of them pathological. It could. for example, be mainly due to our attempt to improve our social accountancy, and having begun spending more of our tax-dollars on restoring the damage we have done to the environment, and treating that as fiscal prudence rather than fiscal irresponsibility. Or it could be due to our society having become far more urbanized than it had been, and with large cities a host of services like subways, schools, libraries are needed. Ditto the new standards of education needed to serve the new technologies that have taken over. In order to satisfy that need more public spending is necessary to pay for new post-secondary training and education. If you don't address that you are guilty of fiscal neglect rather than prudence.

Another important string you need on your theoretical harp care of that is "systems theory." This, borrowed from science and engineering, identifies the subsystems within a system that must be kept in good functioning order if the system as a whole is to function. As in an automobile in which all the subsystems such as brakes, engine, electrical, electronic subsystems, transmission, engine must be kept in good functioning order. Averaging out their efficiency to a happy result is not a solution – they must all individual be in good order, if the car is to budge without being a menace to human life. That concept when I was introduced to it was being seriously considered in many universities, under the leadership of Jay Forrester, Dennis L. Meadows and others. Courses were given in economics faculties. No longer, the very concept of multiple, different factors that can be involved in higher prices. Some may be controlled, others should be recognized as investment in material and human public capital. What has happened to the economics profession is that it has allowed its wits to be highjacked by those who live by interest-rates and a monopoly position for it as what has been called the "dominant revenue" whose volume and monopolist powers are taken to be a reliable index of the society's well being.

Thirty years ago, before COMER was founded I wrote a booklet *Babel's Tower: The Dynamics of Economic Breakdown* that is still in good supply. It lends itself to the development of all sorts of simple and effective policy techniques explained in the booklet.

That is the approach that has disappeared even from the horizon of critics like those to which *The New York Times* is so generously devoting space. That indicates the amount of damage done by the take over of our economics curricula throughout the university world by the "self-balancing market" model economics curricula in our universities. We have been shorn of the knowledge of our history and what the lessons learned for it and applied so fruitfully in the first few postwar decades.

Getting Close to the Source of the Trouble

However, Mr. Stein in parts of his article is getting close to the source of the trouble.

He writes: "The plain truth, as I paraphrase my sainted father for the millionth time, is that we simply do not know how the various parts of the monetary machine work on the economy. (We don't seem to know much about how the fiscal parts work, either. Anyone who would have guessed that we would have run federal budget deficits the size of these since 2001 without major inflation would have failed any basic macroeconomics final examination in 1966. It simply was not part of any economic system we knew about. In some way, this may this may have had some validity in an area I am generally skeptical about: 'supply side' or 'voodoo economics.')"

Mr. Stein should apply the basic concepts of systems theory to distinguish what may be or may not be what he chooses to call "voodoo economics." What he should realize is that no verifiable part of our history should be dismissed not even with a similar acknowledgment. In 1988, to bail out the US banks from their heavy losses in taking over the Savings and Loans real estate firms, the Bank for International Settlements (BIS) brought in its *Risk-Based Bank Capital Requirements*. This declared the debt of central governments in developed countries "risk-free." and hence needing no down payment for banks to acquire. As a result banks loaded up with gobs and gobs of the stuff, and clipped the coupons to replace their disappeared revenue. In Canada the banks holding of central Canadian debt quadrupled approximately to $80 billion Canadian dollars. At the same time the BIS pushed interest rates into the skies "to attain zero inflation." In their eagerness to bail out the banks from their huge losses, they – and the central bankers gathered around them – overlooked a detail: when you push u interest rates, the market value of pre-existent bond hoards with lower coupons plunges. That is what happened to such an extent that the Mexican peso lost some 40% of its value, and not only did the Mexican banks have to be nationalized once again, but eventually, made whole by the government of Mexico yet again, ended up 85% in foreign hands where they remain to this day. That was a bitter pill for the pioneer of nationalism in Latin America to swallow. But then Mexico and its nationalism had been put through the ringer.

Allen Good's cartoons will return.

Under the North American Free Trade Treaty that they had been conned into entering because Washington assured them Canada desired so badly, at the same time that it assured Canadians that it was the Mexicans who were the ardent suitors in the situation, the Mexicans had actually shorted their own currency by issuing *tesobonos* – that gave the owners the option of redemption in US dollars even they had purchased them in pesos. In effect it was a case of Mexico shorting its own currency. This practically collapsed the Mexican currency with a flight of capital by those who had advance knowledge of what was in store to send their money abroad. So shattering was the effect that it contribued to mass migration of workers, legal and illegal into the US that led to the present wall-building exercise by the US on its southern border, that is hardly the most attractive aspect of Panamericanism.

So drastic was the Mexican economic collapse, that it threatened to bring down the world monetary structure. And on the initiative of President Clinton a $51 billion standby fund was arranged with the US, the IMF and Canada putting up the largest standby facility to that date.

What Really Gave the World a Period of Low Interest Rates

But another more benign effect of this whole sordid chapter was that it convinced Washington that the days of sky-high interest rates were over in view of the government bond hoards that the private banks internationally had accumulated to replace their lost capital.

So to arrange that the US government brought in accrual accountancy that the US government along with just about every other government in the capitalist world had resisted bringing in. Instead what government used was known as "cash accountancy" – when a government built or acquired a building, a bridge, a road, it wrote off the entire spending in the year when the financing was arranged and in year two listed the asset value at a token one dollar. Naturally this had some drastic effects on the "fiscal performance." It led to the attempt collect more taxation than was necessary, and that extra hump of taxation on price created the illusion of more inflation than existed. It also created the false semblance of a budgetary deficit that was not necessarily there. Meanwhile any debt incurred for the acquisition of the given capital asset.

The revised bookkeeping, worked back to the year 1959, first appeared in the Department of Commerce figures beginning with January 1996, that showed an increased item under "Savings" of well over $1.3 trillion. This it was not, since the term "savings" is usually reserved by economists to refer to cash reserves or in short term, top quality short-term reserves that can readily be converted into cash. However, that kept interest rates low to give Clinton a second term, the world its spell of low interest rates that led to the high tech stock boom.

There remains a further major clean-up job to be done on government accountancy. In the 1960s Theodore Schultz had been awarded the Bank of Sweden Nobel Prize for Economics, for his work that resulted in the recognition of investment in human capital – education and skills and hence in health, and social services that protect the vessels that hold this precious investment. Schultz reached that conclusion because of the vast error that he and hundreds of other young economists had made when they had been sent by Washington to Germany and Japan to predict how long it would be before those two powers would be able to reappear as formidable competitors on world markets. Twenty some years later Schultz concluded that he and his colleagues had been so wide of the mark because they had concentrated on the physical destruction and overlooked that he high education and skills of the working population had come through the war essentially intact. Hence his conclusion that investment in human in human capital is the most profitable investment a country can make. Today that important conclusion has been forgotten again along with the once celebrated name of Theodore Schultz.

All this should help convince Mr. Stein of the importance of systems theory in helping him in his investigations. My congratulations to both *The New York Times* and to him for their effort. May you pursue it to its logical conclusion.

William Krehm

The Ever Thinner Narrower Newspage

In the olden days you had at least to cross the street to get a view of the two sides of a vital problem. That is no longer the case. In a recent *The Globe and Mail* (09/17), page one carries an article headed "Use soaring loonie to go high tech, Flaherty says," by Sara Perkins that enlightens us: "As the loonie hits a 30-year high, the federal Finance Minister is calling on the beleaguered manufacturing sector to compete with other countries by boosting investment in high technology rather than relying on cheap labour.

"Canadians with plans to go shopping or travelling south of the border are cheering the news that the dollar topped 97 cents US last week after gaining 14% this year, because it makes it cheaper to buy goods priced in US dollars. But for manufacturers and exporters of everything from food packages to cars, the higher Canadian dollar makes their exports less competitive, meaning more pain for the struggling sector that depends on selling its products to Americans.

"'Some economists are predicting the dollar's rise will dampen Canada's hot economy, as Canadian products become more expensive in the US, which is in the grips of a slowdown. If the manufacturing industry is to succeed, it must become more productive and more technologically sophisticated,' Mr. Flaherty said.

"The higher dollar means that technology imports that might enhance productivity are now much cheaper for Canadian manufacturers. In addition to that advantage, the Finance Minister hinted the government is considering extending a two-year tax break for manufacturers who buy new machinery. He calls the move, which currently expires at the end of 2008, a shot of adrenaline for the sector. Yesterday, he cited it as the most important thing the government has done to help the industry cope with the soaring looney."

However, new technology does not take care of it itself. It needs more highly trained executives and workers on the floor, more conversant with electronics and internet communication to direct it, look after it when it breaks down as all new as well as old technologies have a way of doing. That means that our Finance Minister should be looking to the education and the training of the more technologically literate personnel in our universities, secondary schools and colleges. Is that taking place?

You need only turn to the other side of the same newspaper page to get hit in the eye with the answer.

Our Neglected Human Investment

"Mad over prices, students refuse to go buy the book" by Roy MacGregor, under a Peterborough, Ontario, dateline: "The sign, at first surprising is soon understandable: 'Know the Daily Limit on Your Debit or Credit Card Before you come to the Cash.'

"The printed sign stands before the checkout at the Trent University bookstore. As one student leaves, one from the long line that snakes far down the corridor is allowed to enter. They groan, coming and going. 'Here goes another 125 bucks,' a young woman says as she checks her backpack at the entrance.

"'Jesus!,' a young man says as he flips over a 'used' book on organic chemistry: $113.50. There is a sense of conspiracy that cannot be proved, a sense of helplessness. No wonder they make them park their backpacks at the door – just check the stacks: *Principles of Instrumental Analysis* – $154; *Essentials of Genetics* – $125; Fourth Canadian edition of *Organizational Behaviour,* used, $87. Some of the titles even seem slightly ironic: *Financial Accounting: A Critical Approach to Developing Markets,* a soft-cover: $131.35.

"The reason so many of the stacked books are tagged 'used' and seem in good shape is that many of them have hardly been opened and often are barely referred to by teachers and professors who stamp "Required" over the stacks of texts. It is a serious issue and not just Canadian.

"According to a US Government Accountability Office survey, textbook prices almost tripled between 1986 and 2004. More than half of the students involved in one national US study say they have decided to go text-free and damn the consequences. Often, there are none, as the "Required" book ends up not required at all.

No wonder that a California public interest group published a report called "Ripoff 101 – How the Current Practices of the Textbook Industry Drive Up the Cost of College Textbooks."

RENEW TODAY!
(SEE PAGE 2)

There is clearly a logical breach in the reasoning or even a suggestion of a split personality in an eminence in the government that Mr. Flaherty undoubtedly is. His concern for using our high looney to get a higher technology by giving employers a tax holiday. However, he is undisturbed not only by the explosion of post-secondary education costs but by the abuses in the pricing of textbooks. Unless our government wades in with the same fervour to assure this country of a continued and indeed expanded supply of engineers and scientists, a lot of the glittering new equipment that corporations will have acquired with the savings from the two year tax holiday or its contemplated extension will be wasted. Astounding that the connection should have escaped our minority government. In this it shows the insensitivity of a government with a 105% backing in Parliament.

Are the technologies contemplated perhaps so advanced that they will require no correspondingly skilled engineers, scientists and mechanics to look after and improve upon? Or is it just that social prejudices die slowly, and the thinking of Finance Minister Flaherty and his cabinet colleagues has not advanced so far from that of cabinet ministers in Britain during the industrial revolution, when machines were brought in to increase the social distance and the contrast in rewards rather than bring them closer together?

On page 5 of this issue, I recount how Theodore Schultz was awarded the Swedish Bank prize for his paper establishing, on the basis of their surprisingly rapid recovery from the destruction of the war, that human capital is the most productive of investments. Today, however, the name of Schultz is practically unknown, as is the reason for his celebrity status in the 1980s. For ours is an age when the gap between the living standards of ordinary workers and artisans and the industrial and particularly the financial upper elite is ever widening. And as a result the name of Schultz has been virtually forgotten except by COMER.

That explains why the two sides of the one sheet of *The Globe and Mail* are not on speaking terms. Or was it a tactful way of a doughty lay-out man of expressing a dissenting reflection about the direction in which the world is headed?

W.K.

Rogue Financing Knows No Fatherland

Rogue financing, cornered on one continent, seems to have grown wings to turn up on another. Thus the American subprime mortgages tailored to the need of American bad credit risks, have reappeared of all places in Germany – very different as their banking systems might be. *The Wall Street Journal* (20/08, "Debt Puts German Banks in a Bind" by Carrick Mollenkamp, Edward Taylor and Ian MacDonald) informs us: "People around the world are snubbing many types of short-term debt as credit worries spread. That is posing particular problems for German banks, which issue a lot of such debt, known as 'commercial paper.'

"Many used borrowed money to buy securities, some of which were backed by US mortgages contracted to people with weak or no credit. Adding to investor concern is a lack of transparency. Many banks hold their loans in off-balance sheet affiliates called 'conduits' in German industry parlance.

"Mainly because of conduits, issuance of asset-backed commercial paper has exploded. As of March 31, there was $983 billion of such paper globally, up about fivefold from a decade earlier, according to Standard and Poor Corp. Conduits issue commercial paper for terms of less than a year, and use that to buy longer-term bonds paying higher interest rates. The bank behind conduit typically collects asset-management fees and investment profits.

"As in the US, a generous assumption is made that they know what they are doing.

"The conduit business model breaks down if the investors get nervous about the value of the securities the conduit has bought and stop lending the conduit money. In recent weeks the conduits have struggled to find buyers for their payer, and, when they have sold it, buyers have wanted sharply higher interest rates."

Sound familiar? It should. The world has become round in a way that Kepler and Newton did not even suspect.

"That is how a mid-tier German bank IKB Deutsche Industriebank G ended up with big bills due to its commercial-paper buyers that it couldn't pay – and in need of a recent bailout by Germany's market regulator and other German banks. Sachsen LB, a small, German state-owned bank, became the second German bank to require a financial rescue in less than a month, saying on Friday a consortium of banks had stepped in to bail it out after an affiliate faced difficulties selling commercial paper to finance its operations.

"It isn't clear how much there is to be concerned over. Those with conduits say their portfolios are solid and not overly exposed to shaky mortgages. The president of the country's central bank, the Bundesbank, said: 'The heightened risks in the affected areas are insulated, and the profit losses for the credit institutes are limited overall.'

"Across Europe, a number of large banks operate some of the world's largest conduits, including Dutch bank ABM Amro Holding NV and Dutch-Belgian Bank Fortis NV, the UK's Barclay's PLC and Royal Bank of Scotland Group PLC, and Germany's Deutsche Bank AG. Big US operators include Citigroup Inc., Bank of America Corp. and Wachovia Corp., according to a Morgan Stanley report issue Thursday."

A New Heritage of Euphemism

"The difference is that in Germany many smaller banks have relatively large conduits, raising concern should they have to cover shortfalls. Smaller banks exposed to the subprime problems 'may find that their liquidity, risk-management capabilities or financial resources are less adequate to absorb any valuation adjustments.'

"Perhaps our sole consolation is that we have come into a new heritage of euphemisms – 'conduits,' 'risk-management capabilities,' 'risk management' or 'the financial resources less adequate to absorb any valuation or liquidity requirements,' said Antonio Carballo, London team managing director in Moody's Investor Services Inc.'s EMEA Financial Institutions Group."

Some of these euphemisms have been with us for some time now; others we owe to the new wave of trouble. There are Saxon monosyllables that get closer to the essence of their meaning than the fancier Greek and Latin-based polysyllables, but that is hardly the purpose of the exercise.

"Some German banks pushed aggressively into conduits to diversify their business beyond German loans after 2002 when the European Union banned state-backed guarantees on some liabilities, which had helped them achieve excellent credit rating for decades."

That of course is a favourite phenomenon on either side of the waters. When the governments do not bail out banks they often – as per the Risk-Based Bank Capital Requirements issued by the Bank for International Settlements (BIS) in 1988 allow them to load up with the debt, particularly with government bonds of developed countries without down payment. That not only replaced the capital our banks have already lost. but replaces it with "risk-free" loans.

The loans, however, turned out to be less than risk-free. For when the BIS pushed up interest rates to wipe out "inflation" shortly afterwards without even having properly defined what "inflation" might be, the bonds the banks had loaded up with took a nose-dive because subsequent bond issues carried a higher coupon that sold at par. And so it jogs on. One booboo leading to the next greater one, and the banks ever being bailed out, because after all their basic revenue – interest rates – has been declared the regulator of the welfare of society as a whole.

What is absent in all the opinions cited, is a mention of the one important factor that led directly to this mess that is engulfing the world: the repeal of the basic principle of the banking legislation brought in under Roosevelt in the US that eventually became the rule throughout the Western world: the banks were not allowed to acquire interests in any of the other financial pillars – stock market brokerages or other activities, insurance and real estate. Why? Because each of these pillars had its own liquidity pool that it needed for its own business. Allow the banks to get their mitts on these, and they will inevitably be used as the legal tender base for near-money creation. Near-money is interest-bearing money *created by being lent out rather than by being spent out* as happens when the government produces legal tender. And that – note well – contributes as well to real inflation since it creates a many-storeyed interest burden in the price structure. So that was addressed by raising interest rates still further.

Sometimes I cannot escape the feeling that if you took, say, a bright economics course graduate, who had not been crammed with the nonsense that passes for economic theory in our universities today, and appoint him head of our central bank, he would do a far less disastrous job than the present crew.

William Krehm