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Growth, Debt, and the World Bank

Herman Daly

When I was in graduate school in economics in the early 1960s we were taught that capital was the limiting factor in growth and development. Just inject capital into the economy and it would grow. As the economy grew, you could then re-invest the growth increment as new capital and make it grow exponentially. Eventually the economy would be rich. Originally, to get things started, capital came from savings, from confiscation, or from foreign aid or investment, but later out of the national growth increment itself. Capital embodied technology, the source of its power. Capital was magic stuff, but scarce. It all seemed convincing at the time.

Many years later when I worked for the World Bank it was evident that capital was no longer the limiting factor, if indeed it ever had been. Trillions of dollars of capital was circling the globe looking for projects in which to become invested so it could grow. The World Bank understood that the limiting factor was what they called bankable projects concrete investments that could embody abstract financial capital and make its value grow at an acceptable rate, usually ten percent per annum or more, doubling every seven years. Since there were not enough bankable projects to absorb the available financial capital the WB decided to stimulate the creation of such projects with country development teams set up in the borrowing countries, but with WB technical assistance. No doubt many such projects were useful, but it was still hard to grow at ten percent without involuntarily displacing people, or running down natural capital and counting it as income, both of which were done on a grand scale. And the loans had to be repaid. Of course they did get repaid, frequently not out of the earnings of projects which were often disappointing, but out of general tax revenues of the borrowing governments. Lending to sovereign governments with the ability to tax greatly increases the likelihood of being repaid and perhaps encourages a bit of laxity in approving projects.

Where did all this excess financial capital come from? Not from savings (China excepted), but from new money and easy credit generated by our fractional reserve banking system, amplified by increased leverage in the purchase of stocks. Recipients of new money bid resources away from existing uses by offering a higher price. If there are unemployed resources and if the new uses are profitable then the temporary rise in prices is offset by new production by growth. But resource and environmental scarcity, along with a shortage of bankable projects, put the brakes on this growth, and resulted in too much financial capital trying to become incarnate in too few bankable projects.

So the WB had to figure out why its projects yielded low returns. The answer sketched above was ideologically unacceptable because it hinted at ecological limits to growth. A more acceptable answer soon became clear to WB economists - micro level projects could not be productive in a macro environment of irrational and inefficient government policy. The solution was to restructure the macro economies by structural adjustment free trade, export-led growth, balanced budgets, strict control of inflation, elimination of social subsidies, deregulation, suspension of labour and environmental protection laws - the so-called Washington Consensus. How to convince borrowing countries to make these painful structural adjustments at the macro level to create the environment in which WB financed projects would be productive?

The answer was, conveniently, a new form of lending, structural adjustment loans, to encourage or bribe the policy reforms stipulated by the term structural adjustment. An added reason for structural adjustment, or policy lending, was to move lots of dollars quickly to countries like Mexico to ease their balance of payments difficulty in repaying loans they had received from private US banks. Also, policy loans, now about half of WB lending, require no lengthy and expensive project planning and supervision the way project loans do. The money moves quickly. The WB definition of efficiency became, it seemed, moving the maximum amount of money with the minimum amount of thought.

Why, one might ask, would a country borrow money at interest to make policy changes that it could make on its own without any loans, if it thought the policies were good ones? Maybe they did not really favor the policies, and therefore needed a bribe to do what was in their own best interests. Maybe the goal of the current borrowing government was simply to get the new loan, splash the money around among friends and relatives, and leave the next government to pay it back with interest.

Such thoughts got little attention at the WB which was haunted by the spectre of an impending negative payments flow, that is, repayments of old loans plus interest greater than the volume of new loans. Would the WB eventually shrink and disappear as unnecessary? A horrible thought for any bureaucracy! But the alternative to a negative payments flow for the WB is ever-increasing debt for the borrowing countries. Of course the WB did not claim to be in the business of increasing the debt of poor countries. Rather it was fostering growth by injecting capital and increasing the debtor countries capacity to absorb capital from outside. So what if the debt grew, as long as GDP was growing. The assumption was that the real sector could grow as fast as the financial sector and physical wealth grow as fast as monetary debt.

The main goal of the WB is to make loans, to push the money out the door, to be a money pump. If financial capital were really the limiting factor countries would line up with good projects and the WB would ration capital among countries. But financial capital is superabundant and good projects are scarce, so the WB had to actively push the money. To speed up the pump they send country development teams out to invent projects; if the projects fail, then they invent structural adjustment loans to induce a more favourable macro environment; if structural adjustment loans are treated as bribes by corrupt borrowing governments, the WB does not complain too much for fear of slowing the money pump and incurring a negative payments flow.

If capital is no longer the magic limiting factor whose presence unleashes economic growth, then what is it?

Capital, says Frederick Soddy, merely means unearned income divided by the rate of interest and multiplied by 100 (Cartesian Economics, p. 27). He further explains that, although it may comfort the lender to think that his wealth still exists somewhere in the form of capital, it has been or is being used up by the borrower either in consumption or investment, and no more than food or fuel can it be used again later. Rather it has become debt, an indent on future revenues

In other words capital in the financial sense is the future expected net revenue from a project divided by the rate of interest and multiplied by 100. Rather than magic stuff it is an indent, a lien, on the future real production of the economy in a word it is a debt to be repaid, or alternatively, and perhaps preferably, to not be repaid but kept as the source of interest payments far into the future.

Of course debt is incurred in exchange for real resources to be used now, which as Soddy says cannot be used again in the future. But if the financed project can extract more resources employing more labour in the future to increase the total revenue of society, then the debt can be paid off with interest, and with some of the extra revenue left over as profit. But this requires an increased throughput of matter and energy, and increased labour - in other words it requires physical growth of the economy. Such growth in yesterday's empty-world economy was reasonable - in today's full-world economy it is not. It is now generally recognized that there is too much debt worldwide, both public and private. The reason so much debt was incurred is that we have had absurdly unrealistic expectations about growth. We never expected that growth itself would begin to cost us more than it was worth, making us poorer, not richer. But it did. And the only solution our economists, bankers, and politicians have come up with is more of the same! Could we not at least take a short time-out to discuss the idea of a steady-state economy?

Source: casse <http://tinyurl.com/79868oz>

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The E.C.B. fiddles while Rome burns

Ellen Brown

Fiddling While Rome Burns - media.photobucket.com

"To some people, the European Central Bank seems like a fire department that is letting the house burn down to teach the children not to play with matches." So wrote Jack Ewing in the New York Times last week. He went on:

"The E.C.B. has a fire hose -- its ability to print money. But the bank is refusing to train it on the euro zone's debt crisis.

"The flames climbed higher Friday after the Italian Treasury had to pay an interest rate of 6.5 percent on a new issue of six-month bills . . . the highest interest rate Italy has had to pay to sell such debt since August 1997 . . . .

"But there is no sign the E.C.B. plans a major response, like buying large quantities of the country's bonds to bring down its borrowing costs."

Why not? According to the November 28th Wall Street Journal, "The ECB has long worried that buying government bonds in big enough amounts to bring down countries' borrowing costs would make it easier for national politicians to delay the budget austerity and economic overhauls that are needed."

As with the manufactured debt ceiling crisis in the United States, the E.C.B. is withholding relief in order to extort austerity measures from member governments--and the threat seems to be working. The same authors write:

> "Euro-zone leaders are negotiating a potentially groundbreaking fiscal pact . . . [that] would make budget discipline legally binding and enforceable by European authorities. . . . European officials hope a new agreement, which would aim to shrink the excessive public debt that helped spark the crisis, would persuade the European Central Bank to undertake more drastic action to reverse the recent selloff in euro-zone debt markets."

The Eurozone appears to be in the process of being "structurally readjusted" -- the same process imposed earlier by the IMF on Third World countries. Structural demands routinely include harsh austerity measures, government cutbacks, privatization, and the disempowerment of national central banks, so that there is no national entity capable of creating and controlling the money supply on behalf of the people. The latter result has officially been achieved in the Eurozone, which is now dependent on the E.C.B. as the sole lender of last resort and printer of new euros.

The E.C.B. Serves Banks, Not Governments

The legal justification for the E.C.B.'s inaction in the sovereign debt crisis is Article 123 of the Lisbon Treaty, signed by EU members in 2007. As Jens Eidmann, President of the Bundesbank and a member of the E.C.B. Governing Council, stated in a November 14 interview :

> "The eurosystem is a lender of last resort for solvent but illiquid banks. It must not be a lender of last resort for sovereigns because this would violate Article 123 of the EU treaty."

The language of Article 123 is rather obscure, however basically it says that the European central bank is the lender of last resort for banks, but not for governments. It provides:

> "1. Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as "national central banks') in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments.
> "2. Paragraph 1 shall not apply to publicly owned credit institutions which, in the context of the supply of reserves by central banks, shall be given the same treatment by national central banks and the European Central Bank as private credit institutions."

Banks can borrow from the E.C.B. at 1.25%, the minimum rate available for banks. Member governments, on the other hand, must put themselves at the mercy of the markets, which can squeeze them for "whatever the market will bear" -- in Italy's case, 6.5%.

The Real Reason Eurozone Countries Are Drowning in Debt

Why should banks be able to borrow at 1.25% from the E.C.B.'s unlimited fountain of euros, while the tap is closed for governments? The conventional argument is that for governments to borrow money created by their own central banks would be "inflationary." But private banks create the money they lend just as government-owned central banks do. Private banks issue money in the form of "bank credit" on their books, and they often do this *before* they have the liquidity to back the loans. Then they borrow from wherever they can get funds most cheaply. When banks borrow from the E.C.B. as lender of last resort, the E.C.B. "prints money" as it would if it were lending to governments directly.

The burgeoning debts of the Eurozone countries are being blamed on their large welfare states, but these social systems were set up before the 1970s, when European governments had very little national debt. Their national debts shot up, not because they spent on social services, but because they switched bankers. Before the 1970s, European governments borrowed from their own central banks. The money was effectively interest-free, since they owned the banks and got the profits back as dividends. After the European Monetary Union was established, member countries had to borrow from private banks at interest -- often substantial interest.

And the result? Interest totals for the Eurozone countries are not readily accessible; but for France, at least, the total sum paid in interest since the 1970s appears to be as great as the French federal debt itself. *That means that if the French government had been borrowing from its central bank all along, it could have been debt-free today*.

The figures are nearly as bad for Canada, and they may actually be worse for the United States. The Federal Reserve's website lists the sums paid in interest on the U.S. federal debt for the last 24 years. During that period, taxpayers paid a total of *$8.2 trillion* in interest. That's more than half the total $15 trillion debt, in just 24 years. The U.S. federal debt has not been paid off since 1835, so taxpayers could well have paid *more* than $15 trillion by now in interest. That means our entire federal debt could have been avoided if we had been borrowing from our own government-owned central bank all along, effectively interest-free. And that is probably true for other countries as well.

To avoid an overwhelming national debt and the forced austerity measures destined to follow, the Eurozone's citizens need to get the fire hose of money creation out of the hands of private banks and back into the hands of the people. But how?

Government-owned Banks Can Borrow from the E.C.B.

Interestingly, Paragraph 2 of Article 123 of the Lisbon Treaty carves out an exception to the rule that governments cannot borrow from the E.C.B. It says that *government-owned banks* can borrow on the same terms as privately-owned banks. Many Eurozone countries have publicly-owned banks; and as nationalization of insolvent banks looms, they could soon find themselves with many more.

One possible solution might be for the publicly-owned banks of Eurozone governments to exercise their right to borrow from the E.C.B. at 1.25%, then use that liquidity to buy up the country's debt, or as much of it as does not sell at auction. (The Federal Reserve does this routinely in open market operations in the U.S.) Thus the government's securities would be stabilized, keeping speculators at bay; and the government would get the interest spread, since it would own the banks and would get the profits back as dividends.

Taking a Stand in the Class War

In a November 25th article titled "Goldman Sachs Has Taken Over," Paul Craig Roberts writes:

> "The European Union, just like everything else, is merely another scheme to concentrate wealth in a few hands at the expense of European citizens, who are destined, like Americans, to be the serfs of the 21st century."

He observes that Mario Draghi, the new president of the European Central Bank, was previously Vice Chairman and Managing Director of Goldman Sachs International, a member of Goldman Sachs' Management Committee, a member of the governing council of the European Central Bank, a member of the board of directors of the Bank for International Settlements, and Chairman of the Financial Stability Board . Italy's new prime minister Mario Monti, who was appointed rather than elected, was a member of Goldman Sachs' Board of International Advisers, European Chairman of the Trilateral Commission ("a US organization that advances American hegemony over the world"), and a member of the Bilderberg group. And Lucas Papademos, an unelected banker who was installed as prime minister of Greece, was Vice President of the European Central Bank and a member of America's Trilateral Commission.

Roberts points to the suspicious fact that the German government was unable to sell 35% of its 10-year bonds at its last auction; yet Germany's economy is in far better shape than that of Italy, which managed to sell all its bonds. Why? Roberts suspects an orchestrated scheme to pressure Germany to back off from its demands to make the banks pay a share of their bailout.

Europe is in the process of being "structurally readjusted" by a private banking cartel. If its people are to resist this silent conquest, they need to rise up and, using the ballot box and public banks, throw out the new banking hegemony before it is too late.

Source: http://www.opednews.com/articles/The-E-C-B-Fiddles-While-R-by-Ellen-Brown-111130-696.html
Ellen Brown is an attorney, president of the Public Banking Institute, and author of eleven books.

Government spending is different from household spending

John Hermann

A useful website explaining modern monetary theory is entitled New Economic Perspectives (see http://neweconomicperspectives.blogspot.com). On this website is a video of a talk by Stephanie Kelton, who explains why TINA ("there is no alternative") falls apart as a justification to tolerate unemployment once we understand the relationship between a sovereign government and its currency. The talk is entitled "Why you and I can't spend more than we bring in, but the government can - and probably should".

She makes the point that in the U.S. around 70% of spending is carried out by households, and that whenever there is a significant fall in aggregate demand we should look towards implementing mechanisms designed to boost household spending as the highest priority. Examples of effective measures include targeted tax reductions and government guaranteed employment creation and assistance programs.

Kelton also sees current beliefs and attitudes of politicians within the U.S. and in the Eurozone as major stumbling blocks which need to be overcome before any real progress is possible. The most firmly entrenched of those false beliefs include a widespread perception that there is no alternative to the current economic paradigm (summed up in the mantra "surplus good, deficit bad"), along with the belief spelled out in a recent statement by President Obama that "we are broke".

Contrary to such a viewpoint is the recognition that no sovereign country ever needs to go broke or to worry about going broke. Fears that the U.S. and other sovereign countries like the U.K. and Australia are in danger of falling into the debt traps exhibited by Ireland, Greece, Portugal and Spain are unfounded, because the latter group of countries abandoned their monetary sovereignty when they joined the Eurozone, obliging them to turn to the capital markets (mainly large European banks) in order to fund their deficits.

EU austerity and the crowding out hypothesis
Protesilaos Stavrou

Image Source: Spiegel Online

The EU's response to the financial crisis is established upon the crowding out hypothesis. This hypothesis suggests that public spending/investment crowds out private spending/investment. In other words the more the government spends, the less the private sector will spend. Hence whenever the government spends it actually drains out the market from private spending. This theory was developed by one of the world's greatest economists, Milton Friedman, the leading figure of the School of Chicago (monetarism).

In theory this hypothesis is correct only under one condition, which Friedman himself accepted: if the economy is at **full employment**. That is if the economy is utilizing all its resources efficiently. Under all other conditions, under conditions of unemployment, under-investment, recession etc. this idea that public spending reduces private spending is nothing more than a fallacy. In today's EU triple crisis, this idea has no practical application.

It is upon this fallacy that the austerity measures are established. The idea is that public spending needs to be reduced, the economy be deflated, so that private spending and the forces of the market will bring again an equilibrium that will stabilize the market and in the long-run lead to recovery and growth. The bailouts given to Greece, Ireland and Portugal are permeated by this mode of thinking which is established upon a false theoretical framework.

Therefore what actually happens right now in Europe is that the surplus countries are called to offer their own public money to the fiscally challenged countries that receive the bailouts. That money, instead of being invested into structural works that would stimulate the economy and bring growth, are given directly to the creditors of those countries (mainly banks).

In turn those banks, who currently suffer from the banking sector crisis (the financial crisis that first hit in 2008 and still continues) store all that money, thus preventing it from being recycled (reinvested) in the real economy. They do so because they are quasi-bankrupt and whatever money they get they use to sustain their operations. In that sense they act like black holes that absorb and waste the money they receive. That way the debt crisis, instead of being solved, is being reproduced and that is why the crisis in the EU spirals.

In a period where aggregate demand falls dramatically and the economy if left alone, will shrink considerably, public spending is the only way to prevent the recession from worsening. The effects on the real economies of Greece, Ireland and Portugal show that the reduction in public spending was not covered by an increase in private spending as the "crowding out hypothesis" would suggest. In fact aggregate demand has fallen, leading to increase in unemployment and decrease in income.

In the case of the EU and the euro, public spending (not necessarily at a national level but a European level) is the only way for preventing contagion. Contagion of the crisis would be the worst possible scenario as it would trigger another round of recession, with destructive implications for the single currency and on the socioeconomic structures of the EU. Austerity of the sort that EU practices, is the worst choice during a recession. It is a self-defeating, counter-productive policy based upon a false theoretical framework.

Source: http://www.protesilaos.com/2011/07/austerity-in-eu-and-fallacy-of-crowding.html#.TtTOH2Pz0Xk

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"Anyone who believes exponential growth can go on forever in a finite world is either a madman or an economist" Kenneth Boulding

"The only function of economic forecasting is to make astrology look respectable" John Kenneth Galbraith

The coming derivatives crisis

Editor of *The Economic Collapse* website

Many people have no idea that Wall Street has become a gigantic financial casino. The big Wall Street banks are making tens of billions of dollars a year in the derivatives market, and nobody in the financial community wants the party to end. The word "derivatives" sounds complicated and technical, but understanding them is really not that hard. A derivative is essentially a fancy way of saying that a bet has been made. Originally, these bets were designed to hedge risk, but today the derivatives market has mushroomed into a mountain of speculation unlike anything the world has ever seen before. Estimates of the notional value of the worldwide derivatives market go from $600 trillion all the way up to $1.5 quadrillion. Keep in mind that the GDP of the entire world is only somewhere in the neighbourhood of $65 trillion. The danger to the global financial system posed by derivatives is so great that Warren Buffet once called them "financial weapons of mass destruction". For now, the financial powers that be are trying to keep the casino rolling, but it is inevitable that at some point this entire mess is going to come crashing down. When it does, we are going to be facing a derivatives crisis that really could destroy the entire global financial system.

Most people don't talk much about derivatives because they simply do not understand them. Perhaps a couple of definitions would be helpful. The following is how a recent Bloomberg article defined derivatives....

> Derivatives are financial instruments used to hedge risks or for speculation. They're derived from stocks, bonds, loans, currencies and commodities, or linked to specific events such as changes in the weather or interest rates.

The key word there is "speculation". Today the folks down on Wall Street are speculating on just about anything that you can imagine. The following is how Investopedia defines derivatives....

> A security whose price is dependent upon or derived from one or more underlying assets. The derivative itself is merely a contract between two or more parties. Its value is determined by fluctuations in the underlying asset.

> The most common underlying assets include stocks, bonds, commodities, currencies, interest rates and market indexes. Most derivatives are characterized by high leverage.

A derivative has no underlying value of its own. A derivative is essentially a side bet. Usually these side bets are highly leveraged.

At this point, making side bets has totally gotten out of control in the financial world. Side bets are being made on just about anything you can possibly imagine, and the major Wall Street banks are making a ton of money from it. This system is almost entirely unregulated and it is totally dominated by the big international banks.

Over the past couple of decades, the derivatives market has multiplied in size. Everything is going to be fine as long as the system stays in balance. But once it gets out of balance we could witness a string of financial crashes that no government on earth will be able to fix.

The amount of money that we are talking about is absolutely staggering. Graham Summers of Phoenix Capital Research estimates that the notional value of the global derivatives market is $1.4 quadrillion, and in an article for Seeking Alpha he tried to put that number into perspective....

> If you add up the value of every stock on the planet, the entire market capitalization would be about $36 trillion. If you do the same process for bonds, you'd get a market capitalization of roughly $72 trillion.
> The notional value of the derivative market is roughly $1.4 QUADRILLION.
> I realize that number sounds like something out of Looney tunes, so I'll try to put it into perspective. $1.4 Quadrillion is roughly:
> - 40 TIMES THE WORLDS STOCK MARKET.
> - 10 TIMES the value of EVERY STOCK & EVERY BOND ON THE PLANET.
> - 23 TIMES WORLD GDP.

It is hard to fathom how much money a quadrillion dollars is. If you started counting right now at one dollar per second, it would take 32 million years to count to one quadrillion dollars. Yes, the boys and girls down on Wall Street have gotten completely and totally out of control. In an excellent article that he did on derivatives, Webster Tarpley described the pivotal role that derivatives now play in the global financial system....

> Far from being some arcane or marginal activity, financial derivatives have come to represent the principal business of the financier oligarchy in Wall Street, the City of London, Frankfurt, and other money centers. A concerted effort has been made by politicians and the news media to hide and camouflage the central role played by derivative speculation in the economic disasters of recent years. Journalists and public relations types have done everything possible to avoid even mentioning derivatives, coining phrases like toxic assets, exotic instruments, and most notably troubled assets, as in Troubled Assets Relief Program or TARP, aka the monstrous $800 billion bailout of Wall Street speculators which was enacted in October 2008 with the

> support of Bush, Henry Paulson, John McCain, Sarah Palin, and the Obama Democrats.

Most people do not realize this, but derivatives were at the center of the financial crisis of 2008. They will almost certainly be at the center of the next financial crisis as well. For many, alarm bells went off the other day when it was revealed that Bank of America has moved a big chunk of derivatives from its failing Merrill Lynch investment banking unit to its depository arm. So what does that mean? An article posted on The Daily Bail the other day explained that it means that U.S. taxpayers could end up holding the bag....

> This means that the investment bank's European derivatives exposure is now backstopped by U.S. taxpayers. Bank of America didn't get regulatory approval to do this, they just did it at the request of frightened counterparties. Now the Fed and the FDIC are fighting as to whether this was sound. The Fed wants to "give relief" to the bank holding company, which is under heavy pressure.
>
> This is a direct transfer of risk to the taxpayer done by the bank without approval by regulators and without public input.

So did you hear about any of this on the news? Probably not. Today, the notional value of all the derivatives held by Bank of America comes to approximately $75 trillion. JPMorgan Chase is holding derivatives with a notional value of about $79 trillion. It is hard to even conceive of such figures. Right now, the banks with the most exposure to derivatives are JPMorgan Chase, Bank of America, Goldman Sachs, Citigroup, Wells Fargo and HSBC Bank USA. Morgan Stanley also has tremendous exposure to derivatives. You may have noticed that these are some of the "too big to fail" banks. The biggest U.S. banks continue to grow and they continue to get even more power. Back in 2002, the top 10 U.S. banks controlled 55 percent of all U.S. banking assets. Today, the top 10 U.S. banks control 77 percent of all U.S. banking assets. These banks have gotten so big and so powerful that if they collapsed our entire financial system would implode.

You would have thought that we would have learned our lesson back in 2008 and would have done something about this, but instead we have allowed the "too big to bail" banks to become bigger than ever. And they pretty much do whatever they want. A while back, the New York Times published an article entitled "A Secretive Banking Elite Rules Trading in Derivatives". That article exposed the steel-fisted control that the "too big to fail" banks exert over the trading of derivatives. Just consider the following excerpt from the article....

> On the third Wednesday of every month, the nine members of an elite Wall Street society gather in Midtown Manhattan.
>
> The men share a common goal: to protect the interests of big banks in the vast market for derivatives, one of the most profitable and controversial fields

> in finance. They also share a common secret: The details of their meetings, even their identities, have been strictly confidential.

So what institutions are represented at these meetings? Well, according to The New York Times, the following banks are involved: JPMorgan Chase, Goldman Sachs, Morgan Stanley, Bank of America and Citigroup. Why do those same five names seem to keep popping up time after time? Sadly, these five banks keep pouring money into the campaigns of politicians that supported the bailouts in 2008 and that they know will bail them out again when the next financial crisis strikes.

Those that defend the wild derivatives trading that is going on today claim that Wall Street has accounted for all of the risks and they assume that the issuing banks will always be able to cover all of the derivative contracts that they write. But that is a faulty assumption. Just look at AIG back in 2008. When the housing market collapsed AIG was on the wrong end of a massive number of derivative contracts and it would have gone "bust" without gigantic bailouts from the federal government. If the bailouts of AIG had not happened, Goldman Sachs and a whole lot of other people would have been left standing there with a whole bunch of worthless paper.

It is inevitable that the same thing is going to happen again. Except next time it may be on a much grander scale. When "the house" goes "bust", everybody loses. The governments of the world could step in and try to bail everyone out, but the reality is that when the derivatives market comes totally crashing down there won't be any government on earth with enough money to put it back together again. A horrible derivatives crisis is coming. It is only a matter of time.

Stay alert for any mention of the word "derivatives" or the term "derivatives crisis" in the news. When the derivatives crisis arrives, things will start falling apart very rapidly.

Source: http://theeconomiccollapseblog.com/archives/the-coming-derivatives-crisis-that-could-destroy-the-entire-global-financial-system
The author, whose first name is Michael, edits *The Economic Collapse* website
http://theeconomiccollapseblog.com/contact

A financial coup d'etat in the making?
Marshall Auerback

It is said that the European Union is a remarkably inefficient organization in terms of organizing economic rescue packages, but when it comes to subverting democracy, they are as ruthless and efficient as a well-oiled crime syndicate.

Consider the following: in the space of less than 2 weeks, the eurocrats have managed to eliminate two troublesome elected leaders, whose actions dared to interfere with their broader objectives of finalizing the European

Project -- a project which, to put it bluntly, is looking more and more like a financial coup d'etat.

First, Greece, which has in a sense provided the template: Prime Minister George Papandreou, had the audacity to seek the consent of his own people to decisions that would shape their lives via referendum. Well, judging from the petulant reactions of German Chancellor Angela Merkel and French President Nicolas Sarkozy, this clearly wouldn't do. Blatantly interfering with the internal affairs of a fellow democracy (and an ostensible ally), both lobbied (and threatened) the Greek government, the end result being that Mr. Papandreou was duly shoved aside after backtracking.

And look who's the new PM in Greece: Lucas Papademos, a former ECB official (naturally, with the requisite Goldman Sachs pedigree), in order to implement the latest set of structural reforms, which will almost certainly have the effect of deflating the Greek economy even further into the ground. Of course, the privatizations will go ahead and Greece's rapacious tax evading oligarchs will scoop them up at distressed values (presumably with the cash they've already stashed offshore in the London property market, or Swiss banks), thereby consolidating their control of an increasingly dysfunctional Greek economy. The vast majority of Greeks will suffer horribly. They have no say, in a sense being left with the choice of shooting themselves or a firing squad. Still, it's not a total loss: no doubt Goldman Sachs will reap substantial fees as it helps to auction off these very same state assets.

Across, the Adriatic, it appears as if the Merkozy tandem has also played its cards successfully for Round 2, this time successfully eliminating its troublesome nemesis, Italian PM Silvio Berlusconi. Say what you will about Mr Berlusconi, but in this instance he was right to object to a crude political ploy being foisted on him by the ECB, the French and Germans to accept an irrational and economically counterproductive fiscal austerity program in exchange for support from the likes of the IMF. Ask any Argentinean what IMF support entails.

All Berlusconi had to do was cast his eyes toward Athens to see the likely effect of a renewed assault on the Italian welfare state. But the markets euphoric reaction to his resignation was surreal: akin to turkeys voting for Thanksgiving.

In Rome, this Franco-German powerplay is being overseen by a canny ex-Communist, President Giorgio Napolitano, who is in the process of engineering life-long eurocrat, Mario Monti, as the next PM in Italy. Look at Monti's background: Impeccable credentials: a virtual lifer within the European Union's technocratic governing structures, mingled with some private sector experience as a director of entities such as Coca Cola and, of course, an international advisor to Goldman Sachs.

What is taking place is nothing less than a financial coup d'etat by the Eurozone's rentier class. And it is one of history's sad ironies that, at least in the case of Italy, this is all being engineered by an ex-Communist, who likely would have been chased out of the Italian Government (a la Juan Berlinguer) by a Cold War-driven CIA had this taken place but 30 years earlier.

How have we come to this pass within the EU? It is hard to point to one person. We have seen this vast project moved along by a handful of unelected bureaucrats for several decades or more. Jacques Delors was a truly seminal figure, but he did not act alone. The whole of the European project has been increasingly driven by these unelected tenured eurocrats, who have rotated in and out of various positions within the EU's governing structures and spent a few years' getting the requisite private sector training at a place like GS or JP Morgan.

You could make the case that this started when then French President Francois Mitterrand came to power in the early 1980s, and tried to implement a genuinely fresh progressive economic direction for France. He was promptly undermined until he learned to "play ball" with the powers behind the throne. Since then, the game plan has largely remained the same: European Commissioners set up multiple diktats, rules, regulations, minus - of course - any real kind of democratic recourse when they encounter popular resistance. You start small and build up gradually and create fait accomplis everywhere.

When there is democratic backlash via a referendum, the setback is only temporary. Countries, such as Ireland, which dare to vote the wrong way in a national referendum, do not have their result respected. EU officialdom has generally responded, not by reflecting on a popular expression of democratic will, but by ignoring the results until the silly peasants realize the egregious errors of their ways and re-vote the right way.

If it takes two, or even three, referenda, then so be it. Politically, the interpretation of any aspect of the Treaties relating to European governance have always been largely left in the hands of unelected bureaucrats, operating out of institutions which are devoid of any kind of democratic legitimacy. This, in turn, has led to an increasing sense of political alienation and a corresponding move toward extremist parties hostile to any kind of political and monetary union in other parts of Europe. Under politically charged circumstances, these extremist parties might become the mainstream.

The one figure who emerges as a tragic figure here is George Papandreaou. However ineffectually, Papandreou had been deeply committed to making the October deal work. But as Harvard economist (and Greek government advisor) Richard Parker has noted, Papandreou faced a firestorm on multiple fronts: competitors in his own party who wanted his job; parliamentarians in his party who threatened to bolt over new austerity measures; the wholesale intransigence of Samaras and New Democracy; to say nothing of economy that was deflating into the ground before any real help had arrived. Calling for a referendum became his only instrument to put out multiple fires at once by forcing Greek politicians and their powerful backers to back down and by forcing European leaders back to the table immediately to finalize a workable rescue plan in final form.

Of course, he was bound to fail, given the powerful opposition behind him. The Greek PM was being punished on the one hand by his "allies" in the EU, who have imposed collective punishment on the Greek people because of decades of embedded corruption in the system, in spite of the fact that this particular Prime Minister had come clean. Making Greece a proper functioning democracy was Papandreous raison d'etre for in getting into Greek politics.

And, on the other side, the parasite Greek oligarchs themselves, who saw his actions as frontal attack on their control of the Greek economy, fought to destroy him politically and in effect moving Greece one step closer to a failed state.

And now Greece has provided a most convenient model. You've now manufactured a crisis (that EASILY could have been solved by the ECB years ago - Greece is around 2.5% of Europe's GDP), which is now spreading, but providing ample opportunity to get rid of troublesome politicians who don't do what they are told (effectively embrace this "stability culture" that the Germans bleat on about, but which in reality is nothing more than consolidation of the rentiers' control of the various governments).

Similarly in Italy, the European Central Bank has been buying Italian bonds, but in very half-hearted fashion and certainly not enough to stem the relentless rise in rates. The ECB's new chief, Mario Draghi (also an ex-Goldman man), kicked off his term with a blunt warning that Europe's central bank would not act as a lender of last resort (hiding behind dubious legal technicalities) and thereby put his fellow countryman in a position where his resignation was the only course of action to salvage the country from an immediate financial crisis.

Berlusconi was also an easy target, given his colourful and dubious private history. And his likely replacement, Mario Monti, is a perfect bagman for the financial oligarchs of Europe. He is, indeed, part of what one can rightly refer to as a financial mafia that has wrecked the world economy since 2008. These hatchet men of this murky and opaque financial world are now being appointed to implement austerity on poor working households to save the financial sector from a debt deflation --- an artificial crisis created because of the architecture of the Euro system, which as we know these same financial markets so much celebrated when the euro was launched in 1999. Sadly, a large number of Italians still see the euro as their saviour from a corrupt past, which many associate with the Italian lire and high interest rates, even if the corrupt Berlusconi has been himself intimately linked to the same Euro elite. And Draghi himself has a dubious past: as I noted in a recent post, historically, Italy actively exploited ambiguity in accounting rules for swap transactions in order to mislead EU institutions, other EU national governments, and its own public as to the true size of its budget deficit.

It seems indeed fitting that Draghi is now the man forced to deal with the consequences of this national accounting fraud. But it's hardly just for the people of Europe, all of whom will continue to get crushed under the boot of yet more fiscal austerity, by an increasingly detached and democratically unaccountable elite. No wonder the streets of Madrid, Athens, Rome and elsewhere are beginning to burn.

Source: New Economic Perspectives
http://neweconomicperspectives.blogspot.com/2011/11/financial-coup-detat-in-making.html#more

Will public outrage finally force prosecution of outlaw bankers?
Richard J Eskow

The president's OWS rhetoric about inequality rings hollow when that nest of vipers in the justice department have made it so clear they have no intention of prosecuting criminal bankers.

The president has adopted the language of the 99%, and it's paying off for him. He's surged from a position slightly behind Mitt Romney in last month's CNN polling to a 52%-45% lead against the Republican this week. While other factors were involved, his new rhetoric about income inequality and forcing everybody to "play by the same rules" resonated especially well with voters who have seen their government enforce one rule of conduct for Wall Street and another for the rest of us.

Unfortunately, his Administration hasn't backed up that rhetoric with action. It has steadfastly refused to investigate and prosecute the bank crimes who brought this economy to its knees. So have the chief law enforcement officials for most states. Instead they're trying to cut sweetheart deals that would let crooked bankers go with a slap on the wrist.

People are getting fed up. Grassroots outrage against the lack of prosecutions is giving rise to organized citizen action who are protesting these injustices under a "fair settlement" banner. Will this public backlash become strong enough to finally force national and state governments to enforce the law and protect the economy?

The Excuse Makers

If excuses were investigations there'd be justice for everyone. But only a handful of state Attorneys General, led by New York's Eric Schneiderman, have been willing to stand up to big bankers and their friends in high places. The president himself has been serving as Excuse Maker-in-Chief, as when he told *60 Minutes* that "Some of the most damaging behaviour on Wall Street, in some cases, some of the least ethical behaviour on Wall Street, wasn't illegal."

That's right, of course, in a literal "what the meaning of 'is' is" sense... *Some* of the damaging behaviour wasn't illegal. And *some* car accidents aren't caused by drunk drivers. But many, if not most of them, are. If a country road was littered with whisky bottles and corpses, and the county sheriff hadn't booked anyone for a DUI in three years, people would be asking why he's not doing his job.

That's what many people are asking about this president and his Justice Department.

You can't set your foot down around this place without stepping in excuses. Another Administration official told a bank-friendly reporter at the *Wall Street Journal* that it's too difficult to win convictions for crimes that are as as complicated as banking fraud. "Our job is too hard," the Justice Department seems to be saying.

But it wasn't too hard in the 1980s, when a fairly bank-friendly president named Ronald Reagan was running the Federal government. More than 1,000 bankers were convicted in the Savings & Loan scandal for crimes that were very similar to the ones that led to the 2008 financial crisis. A man named Bill Black led the investigations that resulted in those convictions, and the Obama Justice Department hasn't even asked for his advice.

It isn't hard for juries to understand lying, either, and stock fraud is usually a case of somebody lying to someone else. There seem to be some pretty clear-cut cases of it lying around waiting to be prosecuted, very possibly including some at my old employer AIG.

And it isn't hard to understand widespread and organized rings designed to forge court documents, commit perjury, and evade state taxes. And yet that's exactly what big banks did in order to commit massive foreclosure fraud on US homeowners.

The Doers

People who are familiar with Wall Street fraud have come to believe that the Obama Justice Department just doesn't want to investigate and prosecute bankers. It's gone to great lengths to avoid prosecuting them. In fact, that's become *so* clear to Steve Linnick, Inspector General of the Federal Housing Finance Agency, that he's stopped referring potential criminal cases to the Justice Department at all. Instead he's started sending them to Mr. Schneiderman, who has broad power to bring prosecute financial wrongdoing under a 1927 New York law called the Martin Act.

There is one Attorney General for each of the fifty states. Each of them has the ability to prosecute any of the crimes committed by banks in their own jurisdictions. They can also cooperate with Mr. Schneiderman, whose authority under the Martin Act extends across state lines. That power gives state AGs another tool for protecting their state's residents from fraud and bringing criminal bankers to justice.

And yet, only a handful of brave Attorneys General are willing to enforce the law against bankers. In one way or another, Schneiderman's battle is also being waged by Martha Coakley in Massachusetts, Kamala Harris of California, Beau Biden of Delaware, Jack Conway of Kentucky, and Catherine Cortez Masto of Nevada.

That leaves forty-two other states whose AGs are refusing to enforce the law. And the Obama Administration isn't content to just let bad bankers go free to commit more crimes. It's also pressuring the AGs to accept a cushy deal with the banks that would leave crimes unpunished, homeowners unsafe, and bank fraud victims uncompensated.

The People

It's been a long time coming, but the backlash is here. Occupy Wall Street lit the fire with its "one demand" -- an end to the insanity and a realization that bankers and other oligarchs rule the economy like a medieval fiefdom. And now the demand for economic justice is reaching into state governments and the Department of Justice.

A loose coalition of groups is demanding that more Attorneys General prosecute of bank crimes aggressively, offering support for those who are already moving, and calling on the states to reject the cushy deal that the Federal government and some of the AGs are trying to cut with the banks.

Independent citizen groups and progressive organizations are forming alliances at the state level with unions like the AFL-CIO and SEIU, as well as groups such as Clergy and Laity for Economic Justice. Californians for a Fair Settlement, Pennsylvanians for a Fair Settlement, Nevadans for a Fair Settlement and other state teams have begun putting pressure on each state's Attorney General to reject the Administration-backed deal and immediately begin aggressive investigations and prosecutions.

Like David Dayen, I'm hesitant to embrace the "fair settlement" framing completely until some of those investigations are further along. Based on the overwhelming evidence we've seen so far, a truly fair resolution will probably involve handcuffs, orange jumpsuits, and perp walks along with a financial deal. Financial restitution will need to include, at a minimum:

1. substantial principal reductions for underwater homeowners, along with lower interest rates;
2. a breakup or restructuring of the "MERS" shell game so that it no longer enables deceit, tax evasion, and the conversion of home mortgages from a two-party contract to a commodity bankers can trade and sell without regard to property rights;
3. the right to rent a home that has become distressed; and,
4. a loan modification facility that is *not* administered by the banks themselves.

"Fair Settlement" is a good enough umbrella under which to place these demands, as long as it's clear that prosecutions and real restitution are vital elements of fairness. The question now is, how strong will this movement become? Will the public back these groups in demanding justice and rejecting any more cushy bank deals? If they don't, the country will have serious problems in the years to come.

The president is enjoying the fruits of his rhetoric this week, and it's excellent rhetoric. But he'll need to match his words to his deeds if he wants the rewards to continue, and that means directing his Justice Department to drop the cushy bank agreement and start prosecuting Wall Street wrongdoers. And voters are likely to be unforgiving of state politicians who won the office of Attorney General by promising to uphold the law and then turn a blind eye to "wrong" acts by the "right" people.

It's bad enough to watch powerful people break the law with impunity, shatter the economy, get rescued with taxpayer dollars, and then get to scoff at the law as they walk away unpunished. Here's what's even worse: If they're not brought to justice, they'll do it again.

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Source: *OpEdNews* http://www.opednews.com/articles/Will-Public-Outrage-Finall-by-Richard-RJ-Eskow-111220-773.html Also the *Huffington Post* (December 20, 2011)

Losing manufacturing jobs?
Robert B. Reich

North America and the developed world has been losing manufacturing jobs to China, Latin America and the rest of the developing world. Right? Well, not quite.

It turns out that manufacturing jobs have been disappearing all over the world. Economists at Alliance Capital Management in New York took a close look at employment trends in 20 large economies recently, and found that since 1995 more than 22 million factory jobs have disappeared. In fact, the United States has not even been the biggest loser. Between 1995 and 2002, the U.S. lost about 11 percent of its manufacturing jobs. But over the same period, the Japanese lost 16 percent of theirs. And get this: Many developing nations are losing factory jobs. During those same years, Brazil suffered a 20 percent decline.

Here's the real surprise. China saw a 15 percent drop. China, which is fast becoming the manufacturing capital of the world, has been losing millions of factory jobs. So what's going on?

In two words: higher productivity. All over the world, factories are becoming more efficient. They've installed new equipment and utilized new technology. And that often means fewer jobs.

Market reforms have also played a role. In China, new modern factories

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are replacing large, inefficient state-run plants. The result is that even as China produces more goods than ever before, millions of factory workers have been laid off.

Manufacturing is following the same path as agriculture. As productivity rises, employment falls because fewer people are needed. In 1910, almost a third of adult North Americans worked on farms. Now, fewer than 3 percent do. But North American agriculture is the most productive in the world.

Similarly, global manufacturing output is rising - since the mid '90s up 30 percent - even as worldwide manufacturing employment has been dropping. The two trends are directly related.

So next time you hear a politician complain that manufacturing jobs are fleeing to low-cost countries like China or to Latin America, watch your wallet. Everyone's losing factory jobs.

Robert B. Reich is the Maurice B. Hexter Professor of Social and Economic Policy at Brandeis University, and was the Secretary of Labor under former U.S. President Bill Clinton. This commentary originally appeared on Marketplace, public radio's only daily business news program, on November 5, 2003

Fed economists urged DC to help homeowners directly

Russ Baker

Granting homeowners on the verge of losing their houses $400-$800 sounds like a better way of stabilizing the economy than the current "solution," giving an average of $1,000 through payroll tax reductions to people who already have jobs and houses.

This just in: Not everybody working for the U.S. Fed is evil. And some of them had a pretty great idea for solving the housing crisis. But their concept was not adopted...

In January, 2009, just as Barack Obama was taking office, economists at the Federal Reserve Bank of Boston presented some suggestions for dealing with the mortgage crisis. Their proposal, posted to the Boston Fed's website at the time, called for direct aid to the public, rather than to banks.

Their "Proposal to Help Distressed Homeowners" fell on deaf ears. (This report was brought to our attention by the New England Complex Systems

Institute, whose faculty one of the Proposal's co-authors has joined.)

The report essentially questions the logic of bailing out banks reeling from bad home loans, rather than rescuing the homeowners themselves. It is important and worthy of discussion. Among other things, it implicitly draws attention to the extent to which federal policy is driven by narrow interests, rather than serving broader public needs.

Had Washington stepped in and provided direct loans or grants to the most vulnerable of homeowners, those people might have been able to stay afloat through temporarily difficult circumstances. (It's not like people *wanted* to lose their homes.) And even the bankers would have benefited from this.

Instead, bailout funds went to perpetuating the status quo and enriching the very people whose irresponsibility played a key role in creating the economic crisis.

I called Jeff Fuhrer, a co-author of the report and Executive Vice President and Senior Policy Advisor of the Federal Reserve Bank of Boston. He explained that the report had been produced in late 2008, just as the bailout that did go through, TARP, was being signed into law by George W. Bush. The report would have been an alternative. It also was attractively simple -- and logical--exactly what we want government programs to be.

Fuhrer and his colleagues estimated that having Uncle Sam step in to keep people in their homes would have cost $25-50 billion, a pittance compared to the bank bailouts of $700 billion, plus a whole lot more in short-term loans. (On the positive side, much of the bailout money has now been repaid. Of course, it's also likely that ordinary people would be inclined to pay back such monies.)

The Boston Fed economists offered policymakers two options: loans and grants. Applicants would have to show that they had negative home equity (mortgage more than home value), and that they had suffered significant income disruption. The homeowner would no longer have to interact with the entity that made the original loan, and that entity would have no basis -- or reason -- for foreclosing.

By comparison, the Obama administration's flagship program to help homeowners, HAMP, was quite a different thing: very modest help, rendered permanently. This typically involves a reduction in principal or interest -- or both -- but not necessarily enough to keep people in their homes. Some of these loan modifications reduced mortgage payments by about a quarter, but that ordinarily isn't enough to prevent home loss for someone with no income coming in. Plus, the program was designed to help the lenders, who could just choose to foreclose if they found it more advantageous than working things out. Fewer than 200,000 mortgages have been permanently altered under HAMP, and it has generally not helped the unemployed.

What folks need, instead, is meaningful help for the period in which they're in crisis. As the report notes, research shows that most people who are underwater with their homes ran into a double-whammy: negative equity in a property whose value has declined, and an adverse, life-changing event like job loss. People who suffer one or the other are usually able to handle their mortgage payments, but job loss *plus* a steep decline in home value spells disaster for most.

The proposal by the Boston Fed economists would have solved this problem: after rigorously determining eligibility, the government would directly make a significant portion of the distressed homeowner's mortgage payment, and then either loan the rather minor interest on that amount to the homeowner or make it a grant. Later on, under the loan formulation, when homeowners had recovered, and presumably found employment, they would begin repaying the government. These loans/grants would not exceed a couple of years.

From a political standpoint, a simple, understandable program that keeps people in their homes and doesn't turn into a permanent bailout is a winner.

Today, with even more of an aversion toward spending public funds on *anything at all*, Fuhrer and his colleagues are talking up a drastically reduced homeowner relief package. This would require that lenders work out something liveable for the duration of a person's unemployment or significant reduction in ability to pay.

Fuhrer explained that private lenders could initiate such forbearance if they wanted to, but mostly don't. However, if Uncle Sam got involved, the government would have leverage over Fannie Mae and Freddie Mac, which hold most of the outstanding mortgages, and, in addition, it could if necessary guarantee all approved loans.

The average mortgage payment is $1,400 a month, or close to $17,000 a year -- a huge sum to someone who has lost their job. But the actual cost to service a loan to cover those payments is just about $400 a year. Thus, even if you're providing $400 a year to two million people, the total bill is around $800 million, practically pennies compared to what the banksters got.

The way I calculate it, granting homeowners on the verge of losing their houses $400-$800 sounds like a better way of stabilizing the economy than the current "solution," giving an average of $1,000 through payroll tax reductions to people who already have jobs and houses.

Lots of people have ideas on what should have been -- or should be -- done. But when top thinkers at a major Federal Reserve Bank carefully research and propose them, that's a different kind of news. Yet neither the government nor the media seem to have taken it seriously.

Russ Baker is an author, investigative journalist, and editor-in-chief at the website WhoWhatWhy.com
Source: http://whowhatwhy.com/2011/12/23/fed-economists-urged-dc-to-help-homeowners-directly/

"Economics is extremely useful as a form of employment for economists."
John Kenneth Galbraith

Comment from Prof Steve Keen: This proposal from the U.S. Fed is a partial mortgage Jubilee, and includes the suggestion of a grant to homeowners who are both in negative equity and unemployed, where the grant would pay up to 25% of the repayment costs over a 2 year period. I'm noting it both for its own merit, and because it shows that a direct grant to debtors is feasible within the Federal Reserve system - something that I have seen disputed elsewhere. So a full debt-Jubilee, which I discussed in my recent BBC HARDtalk interview, is also feasible. Since the Jubilee issue is likely to rise in prominence in coming years, it's worth recording this very early proposal that emanated from within the US Fed. Below is the text of the paper:

A Proposal to Help Distressed Homeowners

Chris Foote, Jeff Fuhrer, Eileen Mauskopf, and Paul Willen

With job losses generating more mortgage delinquencies, policymakers might consider whether foreclosure-prevention efforts should help homeowners with payments for a while. We propose a government payment-sharing arrangement that would work with the homeowner's existing mortgage and significantly reduce monthly payments while the homeowner is unemployed.

We believe a payment-sharing plan stands a better chance of preventing foreclosures than longer-term but less significant payment reductions achieved through loan modification. More broadly, payment sharing could not only benefit participating homeowners, but also could protect the housing industry from escalating foreclosures and could stabilize financial markets and the economy.

In our view, previous plans based on long-term loan modifications, have been stymied because (a) contrary to the common wisdom, lenders and mortgage servicers will not always find a modification to be in their best interest, and (b) extant plans are generally unable to offer modifications to those who become unemployed.

The payment-sharing plan we propose has neither of those drawbacks. It could take the form of either a loan or a grant. In both versions, the homeowner would have to provide proof of job loss - or other significant income disruption - and proof of the home's negative equity.

Plan Features

Negative equity does not by itself lead to default unless the amount is extremely high. Owners with negative equity who have not suffered adverse life events (for example, job loss, divorce, or illness) generally stay current on their mortgages. Negative equity is, however, a necessary condition for default. Borrowers who have positive equity usually can sell or refinance. The reason that foreclosures are rising today is that falling housing prices have increased the prevalence of negative equity at the same time unemployment is rising - the so-called double-trigger effect.

The best way to prevent foreclosures right now is by the government offering borrowers who have experienced income disruption some temporary but significant assistance. The two versions of our proposal have five features in common. First, the government pays a significant share of the household's current mortgage payment (25 percent and up) directly to the mortgage servicer. Second, the government's share of the mortgage payment is equal to the percentage decline in family earned income. Third, proof of a recent and significant income disruption is required. Fourth, the assistance ends upon resumption of the borrower's normal income stream - or after two years. Fifth, the plan caps the maximum government payment (say, at $1,500 monthly).

Addressing Challenges

The most difficult design challenge is to avoid attracting homeowners who don't need help and inadvertently letting them game the system (a phenomenon called moral hazard). Eligible homeowners would have to prove that their equity is either essentially zero or negative. In the loan version, program participants would pay an interest rate reflecting the elevated risk the government is assuming. And the grant version would explicitly exclude homeowners having enough income (or wealth) to continue making mortgage payments despite negative equity.

The Loan Version

In the loan version, the government's payments accrue to a loan balance to be repaid with interest at a future date. Government payments end when the homeowner's income stream has been restored, or after two years, whichever is sooner. Because the household's mortgage payments may rise (for example, with an adjustable-rate mortgage), the government's payment is capped at a predetermined amount. When borrowers stop receiving government payments, they begin repaying them. They have five years to do so. If the home is sold for more than the value of the mortgage balance, the government has first claim on any remaining equity, up to the value of the loan balance, including accrued interest.

If after the payment-assistance period, the homeowner still cannot afford the monthly payment on the original mortgage, the foreclosure process may begin. The government might then seek loan repayment as it would for education loans—for example, by placing liens on future income.

The Grant Version

In the grant version, the government would provide at least 25 percent of the monthly mortgage payment for up to two years without requiring repayment. Homeowners whose adjusted gross income (average income in the two years prior to income disruption) exceeds a to be specified multiple of median family income in 2008 would not be eligible, a useful if imperfect means of excluding very high-income homeowners who likely have accumulated significant wealth to self-insure against temporary income loss.

Advantages and Disadvantages

The plan provides a significant but temporary reduction in the homeowner's payment during the period of income loss—an advantage over loan-modification programs, which do not always lower payments sufficiently and sometimes even raise them—by adding missed payments to the outstanding loan balance. For lenders, servicers, and second-lien holders, the plan contains a more realistic recognition of their incentives and no pressure to do mortgage modifications. Even if foreclosure cannot be avoided when the government aid terminates, the housing market is likely to have recovered enough that disposal of the property will garner a higher price.

On the downside, the plan probably cannot stop homeowners who have extreme negative equity—say, 40 percent or greater—from defaulting when government aid ends. Indeed, the plan may merely delay foreclosure without any guarantee of economic or social benefit. Another concern is that the borrowers who should get help may choose to default rather than pursue a government loan. Meanwhile, the grant version raises the potential for moral hazard.

Finally, administering the program does require some cooperation from mortgage servicers—for example, giving applicants their outstanding loan balances and some home-price information. If the government chose to offer payment for such assistance, that would add cost.

Estimating Costs

The cost of the grant version is easier to estimate than the cost of the loan version. The civilian labor force is about 155 million persons. With the unemployment rate at 9.4 percent in July 2009 and continuing high, more than 14 million workers will be unemployed. An upper bound on the share of unemployed persons who are likely to be homeowners is the national homeownership rate of about 68 percent. That suggests 9.5 million unemployed homeowners. A very high upper bound on the share of unemployed homeowners likely to have negative equity is 35 percent, which implies that about 3 million persons would be eligible for the program. According to nationwide data on individual mortgages, the average mortgage balance of those who are 60-plus days delinquent is approximately $200,000, with an average interest rate of 7.7 percent.

Assuming a 30-year amortization schedule, the average yearly payment is $17,111. If the government pays 50 percent of the yearly cost on average, then the cost of providing help to 3 million homeowners is about $25 billion annually, perhaps $50 billion overall. That amount is lower than the costs of other foreclosure prevention plans.

The loan version's cost would be smaller. Indeed, if all participants paid back their government loans, the program would cost virtually nothing in present value. Some borrowers, however, will default, and the government may therefore incur unrecovered costs. It is hard to estimate the degree of default, but the number is likely lower than in existing programs. Although no program for preventing foreclosures is perfect, we believe that ours has the best chance of success because it addresses two of the leading causes of current foreclosures in a way that other plans cannot. Policymakers may decide the plan needs tweaking, but the spillover effects of escalating foreclosures call for urgency.

Chris Foote, Jeff Fuhrer, and Paul Willen are research economists at the Federal Reserve Bank of Boston. Eileen Mauskopf is a research economist at the Board of Governors of the Federal Reserve System.

Goldman Sachs has taken over
Paul Craig Roberts

The Germans bond auction failure, an orchestrated event to punish Germany and to warn the German government not to obstruct "unity" or loss of individual sovereignty. Who will rule the New Europe? Obviously, the European banks and Goldman Sachs.

Bankers have seized Europe

On November 25, two days after a failed German government bond auction in which Germany was unable to sell 35% of its offerings of 10-year bonds, the German finance minister, Wolfgang Schaeuble said that Germany might retreat from its demands that the private banks that hold the troubled sovereign debt from Greece, Italy, and Spain must accept part of the cost of their bailout by writing off some of the debt. The private banks want to avoid any losses either by forcing the Greek, Italian, and Spanish governments to make good on the bonds by imposing extreme austerity on their citizens, or by having the European Central Bank print euros with which to buy the sovereign debt from the private banks. Printing money to make good on debt is contrary to the ECB's charter and especially frightens Germans, because of the Weimar experience with hyperinflation.

Obviously, the German government got the message from the orchestrated failed bond auction. As I wrote at the time, there is no reason for Germany, with its relatively low debt to GDP ratio compared to the troubled countries, not to be able to sell its bonds. If Germany's creditworthiness is in doubt, how can Germany be expected to bail out other countries? Evidence that Germany's failed bond auction was orchestrated is provided by troubled Italy's successful bond auction two days later.

Strange, isn't it. Italy, the largest EU country that requires a bailout of its debt, can still sell its bonds, but Germany, which requires no bailout and which is expected to bear a disproportionate cost of Italy's, Greece's and Spain's bailout, could not sell its bonds.

In my opinion, the failed German bond auction was orchestrated by the US Treasury, by the European Central Bank and EU authorities, and by the private banks that own the troubled sovereign debt.

My opinion is based on the following facts. Goldman Sachs and US banks have guaranteed perhaps one trillion dollars or more of European sovereign debt by selling swaps or insurance against which they have not reserved. The fees the US banks received for guaranteeing the values of European sovereign debt instruments simply went into profits and executive bonuses. This, of course, is what ruined the American insurance giant, AIG, leading to the TARP bailout at US taxpayer expense and Goldman Sachs' enormous profits.

If any of the European sovereign debt fails, US financial institutions that issued swaps or unfunded guarantees against the debt are on the hook for large sums that they do not have. The reputation of the US financial system probably could not survive its default on the swaps it has issued. Therefore, the failure of European sovereign debt would renew the financial crisis in the US, requiring a new round of bailouts and/or a new round of Federal Reserve "quantitative easing," that is, the printing of money in order to make good on irresponsible financial instruments, the issue of which enriched a tiny number of executives.

Certainly, President Obama does not want to go into an election year facing this prospect of high-profile US financial failure. So, without any doubt, the US Treasury wants Germany out of the way of a European bailout.

The private French, German, and Dutch banks, which appear to hold most of the troubled sovereign debt, don't want any losses. Either their balance sheets, already ruined by Wall Street's fraudulent derivatives, cannot stand further losses or they fear the drop in their share prices from lowered earnings due to write-downs of bad sovereign debts. In other words, for these banks big money is involved, which provides an enormous incentive to get the German government out of the way of their profit statements.

The European Central Bank does not like being a lesser entity than the US Federal Reserve and the UK's Bank of England. The ECB wants the power to be able to undertake "quantitative easing" on its own. The ECB is frustrated by the restrictions put on its powers by the conditions that Germany required in order to give up its own currency and the German central bank's control over the country's money supply. The EU authorities want more "unity," by which is meant less sovereignty of the member countries of the EU. Germany, being the most powerful member of the EU, is in the way of the power that the EU authorities desire to wield.

Thus, the Germans bond auction failure, an orchestrated event to punish Germany and to warn the German government not to obstruct "unity" or loss of individual country sovereignty.

Germany, which has been browbeaten since its defeat in World War II, has been made constitutionally incapable of strong leadership. Any sign of German leadership is quickly quelled by dredging up remembrances of the Third Reich. As a consequence, Germany has been pushed into an European Union that intends to destroy the political sovereignty of the member governments, just as Abe Lincoln destroyed the sovereignty of the American states.

Who will rule the New Europe? Obviously, the private European banks and Goldman Sachs.

The new president of the European Central Bank is Mario Draghi. This person was previously Vice Chairman and Managing Director of Goldman Sachs International and a member of Goldman Sachs' Management Committee. Draghi was also Italian Executive Director of the World Bank, Governor of the Bank of Italy, a member of the governing council of the European Central Bank, a member of the board of directors of the Bank for International Settlements, and a member of the boards of governors of the International Bank for Reconstruction and Development and the Asian Development Bank, and Chairman of the Financial Stability Board. Obviously, Draghi is going to protect the power of bankers.

Italy's new prime minister, who was appointed not elected, was a member of Goldman Sachs Board of International Advisers. Mario Monti was appointed to the European Commission, one of the governing organizations of the EU. Monti is European Chairman of the Trilateral Commission, a US organization that advances American hegemony over the world. Monti is a member of the Bilderberg group and a founding member of the Spinelli group, an organization created in September 2010 to facilitate integration within the EU.

Just as an unelected banker was installed as prime minister of Italy, an unelected banker was installed as prime minister of Greece. Obviously, they are intended to produce the bankers' solution to the sovereign debt crisis.

Greece's new appointed prime minister, Lucas Papademos, was Governor of the Bank of Greece from 2002-2010, also Vice President of the European Central Bank, and currently is a member of America's Trilateral Commission.

Jacques Delors, a founder of the European Union, promised the British

Trade Union Congress in 1988 that the European Commission would require governments to introduce pro-labour legislation. Instead, we find the banker-controlled European Commission demanding that European labour bail out the banks by accepting lower pay, fewer social services, and a later retirement.

The European Union, just like everything else, is merely another scheme to concentrate wealth in a few hands at the expense of European citizens, who are destined, like Americans, to be the serfs of the 21st century.

Paul Craig Roberts was an editor of the *Wall Street Journal* and an Assistant Secretary of the U.S. Treasury. His latest book, HOW THE ECONOMY WAS LOST, has just been published by *CounterPunch/AK* Press. Source: http://www.opednews.com/populum/printer_friendly.php?content=a&id=141877

Monetative

This is part of the mission statement of the German monetary reform website *Monetative*, which is associated with economic sociologist Prof Joseph Huber.

Taking Money Creation back into Public Hands

The financial crises of the recent past are rooted in the monetary system as it stands today. This system creates excessive credit which inevitably feeds speculative bubbles, asset and consumer price inflation, and results in over-indebtedness. In order to work properly, the economy needs to rely on a stable and just monetary system. That is why we call for

1. the full re-establishment of the public prerogative of creating money
2. an end to the creation of money by means of commercial bank credit
3. spending new money into circulation debt-free through public expenditure.

Money makes the world go round. Who makes the money go round?

Everybody uses money as though it were self-evident. But the actual functioning of the monetary system remains just as nebulous as its characterisation as ‘fractional reserve system’ or ‘multiple credit creation’. This works to the benefit of the banks. They have in effect usurped the prerogative to create money by crediting 80-95 % of the means of payment into circulation in the form of demand deposits on current accounts.

An increasing part of the money supply has of late fueled purely financial transactions which have no benefit for the real economy, but have caused much real damage to it. The barely restrained creation of credit drives business cycles and the stocks and securities markets into irrational exuberance - wildly overshooting in boom periods, while resulting in over-indebtedness and a severe under-supply of money in ensuing crises. If banks themselves go bust, their customers’ deposits and savings are at risk. If the state then intervenes to bail out the banks and vouch for the public's deposits, governments in effect privatize banking profits while passing the losses on to the public.

Banks act as individual companies. They are duty bound neither to macroeconomic goals nor to the common interest. Leaving to them the weighty prerogative of creating the official means of payment is untenable. Money and the monetary order represent concerns of constitutional importance.

Reference: http://www.monetative.de/?page_id=71