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For a just and sustainable society

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ECONOMIC REFORM AUSTRALIA (ERA)

ERA is a not-for-profit, non-party-political organisation, formed in 1993 as a union of the Economics Review Association and other reform groups. Its long-term goal is to achieve a socially, environmentally and financially sustainable economic system. ERA's commitment to economic sovereignty seeks to return control of the economic and financial system to the people. This requires full public scrutiny and accountability for all economic processes and a recognition that economic systems must serve the people for the global good.

Membership of ERA is open to all who agree with its objectives and overall philosophy, and may be effected by forwarding A$20.00 per annum (A$15 concession; A$10 extra for each additional family member) to the Treasurer (address below), together with address, telephone and fax numbers, and email address. It would be appreciated if new members would calculate the part of the year remaining and remit the appropriate pro-rata amount, with the option of paying for the following year as well (make cheques out to E.R.A.) All members are entitled to receive the regular ERA publication *The ERA review*, and to vote at ERA meetings and participate in organized activities.

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Items suitable for publication may be sent to any member of the editorial committee. Please contact John Hermann if you wish to receive the ERA Review electronically as an email attachment, instead of as a posted copy

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Time to renew your ERA membership

To renew your subscription, fill in the form in the Jan-Feb issue, photocopy it, and send it with your membership renewal cheque or money order (made out to ERA) to

ERA National Treasurer, PO Box 505, Modbury, SA 5092

Annual General Meeting

The next ERA Annual General Meeting will take place at 2pm on Saturday 31st May, 2014, at the SA Conservation Centre (level 1, 157 Franklin Street, Adelaide).

Restructuring of Economic Reform Australia

In a previous issue we hinted at changes which were occurring within the structure of ERA. Basically the two incorporated divisions of ERA (in NSW and SA) have been dissolved and in its place we now have a single unified structure. The full title of the association has been changed to Economic Reform Australia Incorporated, and it has recently become registered with ASIC as a national entity.

A new constitution has been created by an ERA committee, which has considered all of its aspects over the course of a year, and has taken into account suggestions for its improvement by members who have reviewed it. A copy of it may now be downloaded from the ERA website.

The geographic focus of activity for the foreseeable future will be Adelaide, which is the current location of monthly ERA meetings. However ERA will continue to work and liaise with, and to support the activities of, like-minded bodies in every state of Australia, New Zealand, and other countries.

Consistent with this restructuring, ERA has embarked on a plan to redesign and restructure its website, and will employ the services of a website designer over the coming months to implement this plan.

A number of changes have been made recently to the list of ERA officeholders. Dick Clifford was recently appointed as ERA's Public Officer, and Victoria Powell has decided to retire from the positions of Treasurer and Membership Officer. We would like to thank Victoria for all the previous work she has carried out for ERA. The latter positions are currently held by Leona Hermann and Hugh Wigg.

The BoE's sharp shock to monetary illusions

Steve Keen

A couple of weeks ago I took a swipe at Bank of England over a speech by its Governor Mark Carney that was unrealistic about the dangers of a bloated financial sector (*Godzilla is good for you?* March 3). Today I'm doing the opposite: I'm doffing my cap to some researchers at Threadneedle Street for a new paper "*Money creation in the modern economy,"* which gives a truly realistic explanation of how money is created, why this really matters, and why virtually everything that economic textbooks say about money is wrong.

The BoE is going gangbusters to get its message across, with an introductory paper on what money is, and two short videos on what money is and money creation, both shot in its gold vault. It clearly wants economic textbooks to throw out the neat, plausible but wrong rubbish they currently teach about money, and connect with the real world instead.

Economic textbooks teach students that money creation is a two-stage process. At the start, banks can't lend because of a rule called the "Required Reserve Ratio" that specifies a ratio between their deposits and their reserves. If they're required to hold 10 cents in reserves to back every dollar in deposits, then if deposits are $10 trillion and reserves are $1 trillion, the banking

sector can't lend any money to anyone.

Stage one in the textbook money creation model is that the Fed (or the Bank of England) gives the banks additional reserves -- say $100 billion worth. Then in stage two, the banks lend this to their customers, who then deposit it right back into banks, who hang on to 10 per cent of it ($10 billion) and lend the remaining $90 billion out again. This process iterates until an additional $1 trillion of deposits are created, so that the reserve ratio is restored ($1.1 trillion in reserves, $11 trillion in deposits).

That model goes by the name of "Fractional Reserve Banking" (aka the "Money Multiplier"), and depending on your political persuasion it's either outright fraud (If you're of an Austrian economic persuasion like my mate Mish Shedlock) or just the way things are if you're a mainstream economist like Paul Krugman. In the latter case, it lets conventional economists build models of the economy that completely ignore the existence of banks, and private debt, and in which the money supply is completely controlled by the Fed.

In this new paper, the BoE authors state emphatically that "Fractional Reserve Banking" is neither fraud, nor the way things are, but a myth -- and it rightly blames economic textbooks for perpetuating it. The paper doesn't beat about the bush when it comes to the divergence between reality and what economic textbooks spout. In fact, as the paper explains it:

• Rather than banks receiving deposits when households save and then lending them out, bank lending creates deposits. (p1)

• In normal times, the central bank does not fix the amount of money in circulation, nor is central bank money 'multiplied up' into more loans and deposits… (p1)

• Rather than banks lending out deposits that are placed with them, the act of lending creates deposits — the reverse of the sequence typically described in textbooks… (p2)

• While the money multiplier theory can be a useful way of introducing money and banking in economic textbooks, it is not an accurate description of how money is created in reality… (p2)

• As with the relationship between deposits and loans, the relationship between reserves and loans typically operates in the reverse way to that described in some economics textbooks. (p2)

Now if I believed in the tooth fairy, I would hope this emphatic denunciation of the textbook model would cause macroeconomics lecturers to drastically revise their lectures for next week. But I'm too long in the tooth to have such a delusion. They'll ignore it instead.

Their dominant "tactic" -- if I can call it that -- will be ignorance itself: most economics lecturers won't even know that the bank's paper exists, and they will continue to teach from whatever textbook bible they've chosen to inflict upon their students. A secondary one will be to know of it, but ignore it, as they've ignored countless critiques of mainstream economics before. The third arrow in the quill, if they are challenged by students about it (hint hint!), will be to argue that the textbook story is a "useful parable" for beginning students, and a more realistic vision is introduced in more advanced courses.

Here the Bank of England has unfortunately given them a useful "out",

by politely pretending that the money multiplier model "can be a useful way of introducing money and banking". But of course this feint will be pure malarkey. Firstly, the model is utterly misleading -- it's about as useful an introduction to the nature of money and banking as the Book of Genesis is an introduction to the theory of evolution. Once people believe the money multiplier model, they can rarely get their heads around the reality that bank lending creates money, and that this has drastic effects on the level of economic activity.

Secondly, the undergraduate lecturer's "it gets better higher up" line is a ruse. Masters and PhD level courses continue to ignore banks, and though mainstream modellers are introducing all sorts of "financial frictions" into their DSGE models (as Noah Smith pointed out recently), none of them -- with the sterling exception of Michael Kumhof of the IMF -- are actually incorporating banks and their capacity to both create and destroy money into their models.

Why? Because if you admit the reality that banks create money by lending, and that money is destroyed by debt repayment (a point I have to admit that I took some time to appreciate), all the simple equilibrium parables of conventional economics fly out the window. In particular, the level of economic activity now depends on the lending decisions of banks (and the repayment decisions of borrowers). If banks lend more rapidly, or if borrowers repay more slowly, there will be a boom; if the reverse, there will be a slump. As the Bank of England puts it, if new loans simply make up for old ones being repaid, then there is no effect, but if new loans exceed repayment then aggregate demand will increase.

"There are two main possibilities for what could happen to newly created deposits," the bank says. "First, as suggested by Tobin, the money may quickly be destroyed if the households or companies receiving the money after the loan is spent wish to use it to repay their own outstanding bank loans…

"A second possible outcome is that the extra bank money creation can lead to more spending in the economy (p7)."

So from a more realistic and practical perspective, the BoE declares that money matters in macroeconomics because it affects the level of economic activity. This really shouldn't be a big deal -- it's what most people actually believe anyway. But incredibly, mainstream economics pretends that money only affects prices, that it has no impact (or only temporary one) on real activity, and that monetary disturbances are all the fault of government (read central bank) anyway, because a quintessential market institution like a commercial bank can't do anything wrong, can it?

Leading economists can't just ignore this paper, or blithely dismiss it as the foot-soldiers of the profession will do. But I seriously doubt that they will let it challenge their current position.

I will, in particular, be curious to see whether Paul Krugman notes this paper, and how he reacts to it. Krugman has been the most visible and aggressive defender of the proposition that banks don't matter, with this including throwing a haymaker at me for making the case that the Bank of England authors are now making.

"In particular, he [Keen] asserts that putting banks in the story is essential," Krugman wrote in 2012. "Now, I'm all

for including the banking sector in stories where it's relevant; but why is it so crucial to a story about debt and leverage?

"Keen says that it's because once you include banks, lending increases the money supply. OK, but why does that matter? He seems to assume that aggregate demand can't increase unless the money supply rises, but that's only true if the velocity of money is fixed; so have we suddenly become strict monetarists while I wasn't looking? In the kind of model Gauti and I use, lending very much can and does increase aggregate demand, so what is the problem?"

Since then Krugman has continued to press the belief that banks are "mere intermediaries" in lending, that they can be ignored in macroeconomics.

"Yes, commercial banks, unlike other financial intermediaries, can make a loan simply by crediting the borrower with new deposits, but there's no guarantee that the funds stay there," he said in the article *Commercial Banks As Creators of "Money".*

And in the same piece he wrote: "Banks are just another kind of financial intermediary, and the size of the banking sector - and hence the quantity of outside money - is determined by the same kinds of considerations that determine the size of, say, the mutual fund industry."

He has been directly contradicted on these points, not by some Antipodean heterodox economist, but by Thread-needle Street itself, so I will expect Krugman's riposte will be the KISS principle: that while the "loans create deposits" argument is technically true, it doesn't make any real difference to macroeconomics.

After all, Krugman can't just dismiss the Bank of England as being staffed by "Banking Mystics", as he has brushed off the contrary views of others.

Dr Steve Keen is an ERA patron and author of the book *Debunking Economics*, and of the blogsite Debtwatch, and is a fellow at the Centre for Policy development.

Reference:
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New and views from New Zealand

The free (from responsibility) market

Dennis Dorney

Our present government claims that a balanced budget (which it has barely achieved) is evidence of its financial acumen. That would have more credibility if the balance were not achieved by its refusal to pay for anything, insisting instead that the market picks up the tab.

I have mentioned elsewhere that the resurgence of a housing boom has been caused by an acute shortage of houses, due largely to the government not building any, choosing instead to let 'the market' respond to demand. Naturally the market builds only as many houses as necessary to maintain high prices - to build enough to reduce prices would be sheer folly.

There is no incentive to build houses that first-home buyers can afford because, by definition, there is no profit in it. On the other hand there is boom in 4-6 bedroom houses, which can only be trophy houses of the rich because families in New Zealand are no bigger than those in Australia. Finally houses are built where the land is cheapest, not where housing is really needed, and the government and city councils are left, a decade later, with massive infrastructure costs - roads that cannot be economically serviced by public transport and new schools, while the inner city schools atrophy. In the Brave New World of the free market, planning is a dirty word.

The prime example of this is Auckland where rampant population growth is costing a fortune in infrastructure costs, largely funded by tax payers living elsewhere. While I was writing a letter on the subject for my local paper, I found the following data comparing Auckland with Paris:- Paris (population 2.2 million) covers only 105km^2 at a density of 21,000 citizens/km^2. Auckland (population 1.5 million) covers 637 km^2 at a density of 2400 Kiwis/km^2. Is it any wonder that Auckland is one of the least affordable cities in the world? Some Aucklanders are sleeping in the parks. I am sure they would love the chance to sleep in Paris.

Another embarrassing failure of the unregulated market is the leaky homes crisis. Changes to the building code in 1994, resulted in a self-regulated regime, and the apprentice training system for builders and the related building trades was dropped. As a result, some developers and builders knowingly or carelessly constructed buildings with numerous faults and short-cuts. Some local authorities were later found to have issued Building Consents based on insufficient documentation and failed to carry out inspection and completion certificates for buildings, which were later found to have leaking problems. The repairs and replacement costs were estimated in 2009 to be approximately $11.3 billion.

Ironically what little life remains in the New Zealand economy is to be found in Christchurch, where the Government, against its will, must be involved and the rebuild is naturally generating work. However, once again the Government is trying its best to avoid any financial commitment and is leaving it to 'the market' (the insurers) to foot the bill. In the short term there are financial benefits - the insurance settlements are coming from premiums sourced from overseas - but there is a long term cost.

The first is that AMI, the only substantial NZ home insurer, collapsed under the financial stress and was sold to Australian insurer IAG, when a more sympathetic government might have saved it. Secondly, property insurance premiums have doubled as a result of the earthquake. That may seem to be reasonable now but if there happens to be no significant earthquake in NZ within the next century the insurers will make substantial unearned profits, all of which will go overseas. Some councils (Dunedin for one) are self insuring and churches are now uninsurable. The last major problem has been that policy holders, already emotionally stressed, have had ongoing battles with insurers who are stringing out their payments for as long as possible.

The government has involved itself only

where it can see potential votes. It is keen that Christchurch should have stadiums and conference centres because it sees these as being vote-buying toys, but the Christchurch City Council is expected to equally share the cost, even though it is lukewarm about 'assets' that don't generate profits.

If it is not the duty of the government to assume the responsibility for what is a national disaster, then whose is it? How much easier it would have been if we had a government that could generate the funds for national infrastructure as ERA would propose, rather than having to borrow from banks. Given that the new money would produce new labour, there would be no inflation.

In the past, as most ERA members are well aware, the suggestion that the government could create the money supply has always been treated with ridicule because it was hard to persuade the public that the banks create money from nothing. Such a claim was always met with shocked disbelief.

However those days are past. You will probably have heard the following already because, although New Zealand is the first nation to catch the morning rays it is certainly the last to hear news of any consequence, thanks largely to a right-wing press. In its Spring Bulletin, the Bank of England has finally admitted that "*whenever a bank makes a loan, it creates a deposit in the borrower's bank account, thereby creating money."* That should create a little global warming that no-one can object to!

Dennis Dorney is an ERA member living in New Zealand, who makes a regular contribution to ERA Review.

A Comment on *Inequality Revisited*

Richard Giles

June Carbone (ERA Review, Mar-Apr 2014) points to some notable effects of social inequality: the large power that the 'rich and powerful' have in setting the ideology and the agenda of governments; the shifting of taxation onto regressive taxation; the reduction in 'welfare' (under the mantra of 'the end of the era of entitlements'); and the fragmentation of society into classes.

Moreover, she points to a statistic that is crucial to understanding this increasing social inequality, that those running away with the wealth of society are the top one-tenth of one percent of wealth-holders. Such a staggering statistic must make one doubt, first, the socialist view that the origin of modern inequality lies in wages withheld from workers ('surplus value') and, second, the neo-classical economic view that everything will work better once it is privatised.

Unfortunately, the same statistic must make one doubt her view that the trouble begins with the behaviour of greedy company executives in laying off workers and refusing to invest in worker training, and the increasing control of wealthy lobbyists over government programs. Clearly, these are but the effects of the exercise of enormous wealth in the pursuit of its interests. There are reasons here to explain the exacerbation of inequality but nothing like any basic reason for its existence.

Perhaps the basic reason could be this. There are two bases of wealth, *labour* (in which we include capital as 'stored up labour') and *location*. Thus, there are two streams of income, one to the owners of labour and one to the owners of locations (whether those

locations be valuable rural or city properties, mines and quarries, radio frequencies, or ocean sea-beds). The unfortunate fact is that the owners of labour pay most of the taxes. And even more unfortunately, the stream of income from locations is allowed to fall into private pockets.

If we call the stream of revenue from location economic rent, it is the build-up of this rent with the development of society that is placing immense wealth in the hands of those who own or control the most valuable land. From this basis, as Ms Carbone shows, every possible means at hand is used to consolidate and enlarge this wealth.

Richard Giles is an ERA member living in Victoria

Editorial comment: We support these comments of the author, however ERA has always held the view that it is necessary to consider the implications of economic rent acquired by the private sector in its broadest context - not only economic rent which is associated with land locations.

Fair trade, not free trade

David Faber

With the Abbott government secretively negotiating away our economic sovereignty under the looming Trans-Pacific Partnership with the corporate juggernaut of the United States and other Pacific Rim jurisdictions, Free Trade is more topical than ever.

Usually passed off as an uncomplicated good thing, Free Trade dogma has a secular history. Born as a reaction to the restrictions involved in state monopolies and the economic system known as mercantilism [which emphasised commercial war, demographic growth, positive specie trade balances and the like], Free Trade doctrine came into its own with the Industrial Revolution.

Antagonistic to labour market regulation and protectionism and laissez faire domestically, Free Traders have always been globalisers. They see the `free' market as self-regulating nationally and internationally with countries ideally specialising in niche export marketing often at the expense of domestic production and commerce. Free Trade ideology remains recognisably de-regulationist and an essential tenet of militant neo-liberal extremism.

The idea of Fair Trade goes further than the principle and practice of paying an ethical price for coffee. Equitable tax reform is very much a part of the Fair Trade concept. This addresses concern about corporate tax evasion which is crippling the revenue base and service delivery of the public sector, apprehension even amongst the most fiscally conservative of developed states.

In the developing world, the longstanding problem of transfer pricing to avoid taxation at the source of wealth production to transfer value to jurisdictions which are relative tax havens is rife. In May of last year Kofi Annan released a report *Equity in Extractives* showing that tax evasion by resource companies is hamstringing growth in Africa.

Here in Australia the mining vested interests have successfully fought off their obligation to pay a fair share of tax for extracting finite public resources. Notions that Australia can afford to be a cut price quarry without much in the way of a manufacturing or public sector are rampant in the finance sector, press and now government circles. Government plans to reintroduce work choices under other names are part

and parcel of this plot against the people.

On the contrary the Australian economy and society must be a high wage high tech economy if our democracy is not to wither. Australia must be the Scandinavia of Asia. This can never be whilst we try insanely to compete in a race to the bottom with countries which do not permit free labour organisation, rights of assembly and free speech. Rational tariff protection and trade restrictions ought to apply against firms and states which compete unfairly on cost in this way, dumping in our markets with export subsidies and undercutting Australian wages and conditions.

This is not protection for protectionism's sake or the featherbedding of unviable industries. It is the positive construction of a level playing field through state and community action for a just and economically and ecologically sustainable future linked to a rational foreign policy.

Dr David Faber is a visiting research fellow in the School of Economics at the University of Adelaide, and an ERA member.

Free trade de-industrialises countries like Australia

Philip Lawn

As Herman Daly has said, international trade is no longer governed by the principle of comparative advantage – it is governed by 'absolute' advantage, which would be acceptable if all wages, conditions of employment, environmental standards, and taxation/regulatory policies were the same across the world and of high standard.

But they are not the same, and many are of appalling standard. Hence, in a global market with almost perfectly mobile international capital, productive capital simply moves to locations where the cost of production is lowest, but where, more often than not, the low cost of production is due to low wages and low standards – not due to superior efficiency of production.

It's the reason why manufacturing has almost disappeared in Australia and throughout most of Europe. So-called 'free trade' agreements are documents that result in the de-industrialisation of countries with high wages and relatively stringent environmental standards which have been built up over decades. Most of Europe is a mess and Australia only looks to have avoided similar economic problems by plundering its natural environment and calling the liquidation of its natural capital 'income'.

A strong economy is one with a strong primary sector (agriculture, resources, extractive industries), a strong secondary sector (manufacturing), and strong tertiary sector (service industries). The Australian economy has a relatively strong tertiary sector, virtually no secondary sector, and, because of the way it exploits its natural capital, has an unsustainable primary sector.

Look at the high-GDP nations that survived the GFC without a significant economic downturn. These countries are Australia, Norway, and Canada. What do they have in common? They have abundant natural resources - Australia has coal and iron ore, Norway has oil, and Canada has forests and tar sands - which they have been busily liquidating. A short-term but unsustainable solution to a structural problem.

As for those who believe that the

transition to an economy dominated by the tertiary sector is a sign of economic maturity – no, it's not – it's a sign of economic stupidity. So-called 'free trade' agreements will undermine the ability of high-GDP countries to maintain what secondary sector they have and make it almost impossible to rebuild the secondary sector if it has been run down by a process of de-industrialisation caused largely by the degenerative forces of economic globalisation.

Assoc Prof Philip Lawn is an ecological economist working at The Flinders University of South Australia, and an ERA member.

The Global Banking Game Is Rigged, and the FDIC Is Suing

Ellen Brown

Taxpayers are paying billions of dollars for a swindle pulled off by the world's biggest banks, using a form of derivative called interest-rate swaps; and the Federal Deposit Insurance Corporation has now joined a chorus of litigants suing over it. According to an SEIU report:

" Derivatives . . . have turned into a windfall for banks and a nightmare for taxpayers. . . . While banks are still collecting fixed rates of 3 to 6 percent, they are now regularly paying public entities as little as a tenth of one percent on the outstanding bonds, with rates expected to remain low in the future. Over the life of the deals, banks are now projected to collect billions more than they pay state and local governments – an outcome which amounts to a second bailout for banks, this one paid directly out of state and local budgets."

It is not just that local governments, universities and pension funds made a bad bet on these swaps. The game itself was rigged, as explained below. The FDIC is now suing in civil court for damages and punitive damages, a lead that other injured local governments and agencies would be well-advised to follow. But they need to hurry, because time on the statute of limitations is running out.

The Largest Cartel in World History

On March 14, 2014, the FDIC filed suit for LIBOR-rigging against sixteen of the world's largest banks – including the three largest US banks (JP Morgan Chase, Bank of America, Citigroup), the three largest UK banks, the largest German bank, the largest Japanese bank, and several of the largest Swiss banks. Bill Black, professor of law and economics and a former bank fraud investigator, calls them "the largest cartel in world history, by at least three and probably four orders of magnitude."

LIBOR (the London Interbank Offering Rate) is the benchmark rate by which banks themselves can borrow. It is a crucial rate involved in hundreds of trillions of dollars in derivative trades, and it is set by these sixteen mega-banks privately and in secret.

Interest rate swaps are now a $426 trillion business. That's trillion with a "t" – about seven times the gross domestic product of all the countries in the

world combined. According to the Office of the Comptroller of Currency, in 2012 US banks held $183.7 trillion in interest-rate contracts, with only four firms representing 93% of total derivative holdings; and three of the four were JPMorgan Chase, Citi-group, and Bank of America, the US banks being sued by the FDIC over LIBOR manipulation.

Lawsuits over LIBOR-rigging have been in the works for years, and regulators have scored some very impressive regulatory settlements. But so far, civil actions for damages have been unproductive for the plaintiffs. FDIC is therefore pursuing another tack.

But before getting into all that, we need to look at how interest-rate swaps work. It has been argued that the counterparties stung by these swaps got what they bargained for – a fixed interest rate. But that is not actually what they got. The game was rigged from the start.

The Sting

Interest-rate swaps are sold to parties who have taken out loans at variable interest rates, as insurance against rising rates. The most common swap is one where counterparty A (a university, municipal government, etc.) pays a fixed rate to counterparty B (the bank), while receiving from B a floating rate indexed to a reference rate such as LIBOR. If interest rates go up, the municipality gets paid more on the swap contract, offsetting its rising borrowing costs. If interest rates go down, the municipality owes money to the bank on the swap, but that extra charge is offset by the falling interest rate on its variable rate loan. The result is to fix borrowing costs at the lower variable rate.

At least, that is how it's supposed to work. The catch is that the swap is a separate financial agreement – essentially an ongoing bet on interest rates. The borrower owes *both* the interest on its variable rate loan *and* what it must pay out on this separate swap deal. And the benchmarks for the two rates don't necessarily track each other. As explained by Stephen Gandel on CNN Money:

" The rates on the debt were based on something called the Sifma municipal bond index, which is named after the industry group that maintains the index and tracks muni bonds. And that's what municipalities should have bought swaps based on. Instead, Wall Street sold municipalities Libor swaps, which were easier to trade and [were] quickly becoming a gravy train for the banks. "

Historically, Sifma and LIBOR moved together. But that was before the greatest-ever global banking cartel got into the game of manipulating LIBOR. Gandel writes:

" In 2008 and 2009, Libor rates, in general, fell much faster than the Sifma rate. At times, the rates even went in different directions. During the height of the financial crisis, Sifma rates spiked. Libor rates, though, continued to drop. The result was that the cost of the swaps that municipalities had taken out jumped in price at the same time that their borrowing costs went up, which was exactly the opposite of how the swaps were supposed to work. "

The two rates had decoupled, and it was chiefly due to manipulation. As noted in the SEUI report:

" [T]here is . . . mounting evidence that it is no accident that these deals have gone so badly, so quickly for state and

local governments. Ongoing investigations by the U.S. Dept of Justice and the California, Florida, and Connecticut Attorneys General implicate nearly every major bank in a nationwide conspiracy to rig bids and drive up the fixed rates state and local governments pay on their derivative contracts. “

Changing the Focus to Fraud

Suits to recover damages for collusion, antitrust violations and racketeering (RICO), however, have so far failed. In March 2013, SDNY Judge Naomi Reece Buchwald dismissed antitrust and RICO claims brought by investors and traders in actions consolidated in her court, on the ground that the plaintiffs lacked standing to bring the claims. She held that the rate-setting banks’ actions did not affect competition, because those banks were not in competition with one another with respect to LIBOR rate-setting; and that “the alleged collusion occurred in an arena in which defendants never did and never were intended to compete.”

Okay, the defendants weren’t competing with each other. They were *colluding* with each other, in order to unfairly compete with the rest of the financial world – local banks, credit unions, and the state and local governments they lured into being counterparties to their rigged swaps. The SDNY ruling is on appeal to the Second Circuit.

In the meantime, the FDIC is taking another approach. Its 24-count complaint does include antitrust claims, but the emphasis is on damages for fraud and conspiring to keep the LIBOR rate low to enrich the banks. The FDIC is not the first to bring such claims, but its massive suit adds considerable weight to the approach.

Why would keeping interest rates low enrich the rate-setting banks? Don’t they make more money if interest rates are high?

The answer is no. Unlike most banks, they make most of their money not from ordinary commercial loans but from interest rate swaps. The FDIC suit seeks to recover losses caused to 38 US banking institutions that did make their profits from ordinary business and consumer loans – banks that failed during the financial crisis and were taken over by the FDIC. They include Washington Mutual, the largest bank failure in US history. Since the FDIC had to cover the deposits of these failed banks, it clearly has standing to recover damages, and maybe punitive damages, if intentional fraud is proved.

The Key Role of the Federal Reserve

The rate-rigging banks have been caught red-handed, but the greater manipulation of interest rates was done by the Federal Reserve itself. The Fed aggressively drove down interest rates to save the big banks and spur economic recovery after the financial collapse. In the fall of 2008, it dropped the prime rate (the rate at which banks borrow from each other) nearly to zero.

This gross manipulation of interest rates was a giant windfall for the major derivative banks. Indeed, the Fed has been called a tool of the global banking cartel. It is composed of 12 branches, all of which are 100% owned by the private banks in their districts; and the

Federal Reserve Bank of New York has always been the most important by far of these regional Fed banks. New York, of course is where Wall Street is located.

LIBOR is set in London; but as Simon Johnson observed in a New York Times article titled *The Federal Reserve and the LIBOR Scandal*, the Fed has jurisdiction whenever the "safety and soundness" of the US financial system is at stake. The scandal, he writes, "involves egregious, flagrant criminal conduct, with traders caught red-handed in e-mails and on tape." He concludes:

" This could even become a "tobacco moment," in which an industry is forced to acknowledge its practices have been harmful – and enters into a long-term agreement that changes those practices and provides continuing financial compensation. "

Bill Black concurs, stating, "Our system is completely rotten. All of the largest banks are involved - eagerly engaged in this fraud for years, covering it up." The system needs complete overhaul.

In the meantime, if the FDIC can bring a civil action for breach of contract and fraud, so can state and local governments, universities, and pension funds. The possibilities this opens up for California (where I'm currently running for State Treasurer) are huge. Fraud is grounds for rescission (terminating the contract) without paying penalties, potentially saving taxpayers enormous sums in fees for swap deals that are crippling cities, universities and other public entities across the state. Fraud is also grounds for punitive damages, something an outraged jury might be inclined to impose. My next post will explore the possibilities for California in more detail. Stay tuned.

Source: Web of Debt Blog (Ellen Brown) http://ellenbrown.com/2014/04/13/the-global-banking-game-is-rigged-and-the-fdic-is-suing/

Innovation first

Darian Hiles

Richard Denniss argues that productivity drives innovation (*The paradoxes of economic growth,* AFR, 8 April). But innovation is much more than just an ally of productivity. It has traditionally referred to the creation of something new, but today the word has become degraded to mean the level of simple improvements made to the production process in order to create efficiencies and lower costs, i.e. to improve the status quo.

We need to focus on new and quite different products. Holden and Ford were in the former category. They need to be in the latter.

The mobile phone was not the result of a production improvement to the phone handset; it was a complete change and made far more money than productivity improvements to handsets ever would.

Australia is more attuned to the inventive model of Scandinavian countries than to mass production. We need to find new paradigms: ways to move away from existing systems, to focus on better rather than more. Innovation captures the market: it's the key to the future. Productivity improvements just polish it afterwards. Denniss does hint at this: he's on a good thing but we need to go further.

Darian Hiles is ERA President

Destroying a rainforest for economic gain is like burning a Renaissance painting to cook a meal. E.O. Wilson

EU facilitating corporate plunder

Colin Todhunter

Since the economic crisis hit Europe, international investors have begun suing EU countries struggling under austerity and recession for a loss of expected profits, using international trade and investment agreements. Speculative investors are claiming more than 1.7 billion Euros in compensation from Greece, Spain and Cyprus in private international tribunals for the impact of measures implemented to deal with economic crises. This is the conclusion from a new report released by the Transnational Institute (TNI) and Corporate Europe Observatory (CEO).

The report, 'Profiting from Crisis – How corporations and lawyers are scavenging profits from Europe's crisis countries' (1), exposes a growing wave of corporate lawsuits against Europe's struggling economies, which could lead to European taxpayers paying out millions of euros in a second major public bailout, this time to speculative investors.

These lawsuits provide a warning of the potential high costs of the proposed trade deal between theUS and the EU, which has just begun its fourth round of negotiations in Brussels.

Pia Eberhardt, trade campaigner with CEO and co-author of the report says:

"Speculative investors are already using investment agreements to raid the cash-strapped public treasuries in Europe's crisis countries. It would be political madness to grant corporations the same excessive rights in the even more far-reaching EU-US trade deal."

The report examines a number of investor disputes launched against Spain, Greece and Cyprus in the wake of the European economic crisis. In most cases, the investors were not long-term investors, but rather invested as the crisis emerged and were therefore fully aware of the risks. They have used the investment agreements as a legal escape route to extract further wealth from crisis countries when their risky investment didn't pay off.

For example, in Greece, Poštová Bank from Slovakia bought Greek debt after the bond value had already been downgraded and was then offered a very generous debt restructuring package, yet sought to extract an even better deal by suing Greece, using the bilateral investment treaty between Slovakia and Greece. In Cyprus, a Greek-listed private equity-style investor, Marfin Investment Group is seeking €823 million in compensation for their lost investments after Cyprus had to nationalise the Laiki Bank as part of an EU debt restructuring agreement. In Spain, 22 companies (at the time of writing), mainly private equity funds, have sued at international tribunals for cuts in subsidies for renewable energy. While the cuts in subsidies have been rightly criticised by

environmentalists, only large foreign investors have the ability to sue.

Cecilia Olivet, co-author of the report for TNI said:

“At a time when ordinary people across Europe have been stripped of many basic social rights, it is perverse that the EU supports an international investment regime which provides VIP protection to largely speculative foreign investors. It is time to reject a privatised justice system that supports predatory corporate vultures and undermines crucial regulation in the public interest.”

The report also unveils how speculative investors have been backed by international law firms that actively encourage investor-state lawsuits. Law firms are reaping substantial financial rewards in the process. UK-based Herbert Smith Freehills, hired to represent Spain in at least two cases, for example, could earn up to 1.6 million euros for the cases.

Growing controversy around the EU-US trade talks has forced the European Commission to temporarily halt negotiations on the investor rights chapter in the proposed transatlantic deal and announce a public consultation on the issue expected to start this month.

‘Investor rights’ is essentially a big business agenda that constitutes little more than a recipe for the further plundering of economies by powerful corporations. This agenda allows big business to bypass democracy and bully sovereign states into instituting policies that trample over ordinary citizens’ rights in the name of even higher profits (2).

However, the Commission has already indicated that it does not want to abandon these controversial corporate rights, but rather reform them.

Pia Eberhardt:
“The investor-state arbitration system cannot be tamed. Profit-greedy law firms and their corporate clients will always find a way to attack countries for actions that threaten their profits – even when it is much needed legislation to get out of a financial crisis. Corporate super-rights should be abolished.”

The report’s findings show how the global investment regime thrives on economic crises. While speculators making risky investments are protected, ordinary people have no such protection and through harsh austerity policies are being stripped of basic social rights.

Corporate investors have claimed in arbitration disputes more than 700 million euros from Spain, more than one billion euros from Cyprus and undisclosed amounts from Greece. This bill, plus the exorbitant lawyers’ fees for processing the cases, will be paid for out of the public purse at a time when austerity measures have led to severe cuts in social spending and increasing deprivation for vulnerable communities. In 2013, while Spain spends millions on defending itself in lawsuits, it cut health expenditure by 22 per cent and education spending by 18 per cent.

The report’s authors conclude that the European Commission (EC) has played a complicit and duplicitous role, effectively abetting this wave of corporate lawsuits battering crisis-hit countries. Some of the lawsuits have arisen due to debt and banking restructuring measures that were required as part of EU rescue packages. Moreover, the

EU continues to actively promote the use of investor-state arbitration mechanisms world-wide, most prominently in the current negotiations for the controversial EU-US trade agreement.

This whole scenario is but one more ploy to facilitate what has been the biggest shift of wealth from the poor to the rich in modern history (3). The authors state that it is time to turn a spotlight on the bailout of investors and call for a radical rewrite of today's global investment regime. In particular, European citizens and concerned politicians should demand the exclusion of investor-state dispute mechanisms from new trade agreements currently under negotiation, such as the proposed EU-US trade deal. A total of 75,000 cross-registered companies with subsidiaries in both the EU and the US could launch investor-state attacks under the proposed transatlantic agreement. Europe's experience of corporate speculators profiting from crisis should be a salutary warning that corporations' rights need to be curtailed and peoples' rights put first.

Notes

1. http://corporateeurope.org/sites/default/files/profiting_from_crisis.pdf
2. http://www.globalresearch.ca/free-trade-agreements-the-bypassing-of-democracy-to-institute-economic-plunder/5354197
3. http://www.zerohedge.com/news/2013-09-19/druckenmiller-blasts-biggest-redistribution-wealth-poor-rich-ever

About the author:
Originally from the northwest of England, Colin Todhunter has spent many years in India. He has written extensively for the Bangalore-based Deccan Herald, New Indian Express and Morning Star (Britain). His articles have also appeared in many other newspapers, journals and books. His site is at: http://colintodhunter.blogspot.com

Michael Lewis on our totally broken financial system

David Sirota

And why a financial transaction tax would go a long way towards fixing it.

Michael Lewis

If you read one business book this year, make it "Flash Boys" by Michael Lewis. The journalist famous for "Moneyball" and "The Big Short" takes readers inside the parasitic world of high-frequency trading that is harming the broader economy.

The technical architecture of high-frequency trading is right out of a sci-fi movie -- the schemes rely on algorithms that seem artificially intelligent, and the velocity of transaction signals approach light speed. As Lewis recounts, all that technological wizardry is marshaled to let insiders know information before everyone else, which consequently lets those insiders extract wealth from the market.

The good news is that a financial transaction tax can at once raise public resources and disincentivize the most predatory schemes. The even better news is that structural changes in the industry have made such a tax more economically viable than ever.

Before getting to that change, consider the basics of the tax proposal. The idea

is that if a tiny fee is slapped on securities transactions -- say, a cent -- the tax will barely affect the average investor but will force high-frequency, high-volume traders to pay a lot. Consequently, those predators might see less of an upside from -- or even abandon - their market-rigging schemes. And if they don't, then at least the government will generate new resources to enforce laws protecting average investors.

Of course, when this idea gained steam before, it was deflated by those arguing that the tax would prompt stock exchanges to move to jurisdictions that don't impose such a levy. In this tale, the city, state or country that creates a transaction tax won't stop high-frequency trading -- it will only hurt itself by driving financial business to another locale.

On its face, it is a powerful argument -- so powerful, in fact, that when Chicago's municipal government recently considered a financial transaction tax, the proposal was quickly dismissed. The Illinois legislature then gave the Chicago Mercantile Exchange an $85 million tax cut when company executives threatened to move the company out of state.

No doubt, fear of such flight seems logical. Essentially, tax opponents ask us to assume that in the Internet era, stock exchanges -- like many other information-sector enterprises -- are no longer moored to specific geographies because they can supposedly conduct business through any digital conduit.

But that's where the aforementioned structural change has created a flaw in the logic. In a financial world where microseconds are now king, all conduits are not created equal and average Internet velocity is no longer enough. That reality potentially reduces some of the industry's geographic mobility. Why? Because while speculators themselves no longer need to physically be on specific trading room floors, they do need their computers to either be physically near those exchanges' computers or hooked up to them through special ultra-fast conduits. Additionally, the newly computerized exchanges need ever-more massive data centers and conduits to process the accelerating information flow.

All of that technology requires financial firms to make huge investments in lots of immobile digital infrastructure. That means it may now be prohibitively expensive and/or logistically difficult for those financial firms to simply pick up and move. Indeed, just like petroleum companies cannot realistically threaten to leave oil-rich locales if they don't like a tax, parts of the financial world are captive to the locales in which they've built their digital systems.

This is the silver lining of speed-driven finance. Simply put, the federal, state and local governments that host the financial industry have more leverage because, despite threats, they don't have to fear the industry leaving.

The only question, then, is political: Will those governments use this new leverage? Or will they do nothing to protect the average investor?

Source:
http://www.alternet.org/print/economy/michael-lewis-right-our-financial-system-totally-broken

About the author: David Sirota is a staff writer at PandoDaily and the best-selling author of the books *Hostile Takeover*, *The Uprising*, and *Back to Our Future*.

Capital in the 21st Century

ERA Review Editor

Capital in the Twenty-First Century is a 2013 book written by French economist Thomas Piketty. It focuses on wealth and income inequality and their variation and distribution since the 18th century, using datasets from many countries. It was initially published in French, with an English translation released in April 2014. The central thesis of the book is that inequality is not an accident, but rather a feature of capitalism, and can only be reversed through state intervention. The book thus argues that unless capitalism is reformed in a major way, the very democratic order will be threatened.

Source:
http://en.wikipedia.org/wiki/Capital_in_the_Twenty-First_Century

More effective remedies for inequality than Piketty's

Geoff Davies

I have read only reviews of Thomas Piketty's *Capital in the Twenty-First Century*, but clearly it is valuable for documenting the nature and history of inequality over the past century or three, and for highlighting the excessive political power that flows from super-wealth. Yet he frames it in terms of *capital* and *capitalism* and, for all the quality of his diagnosis, his main prescription evidently is just to tax the wealthy, through income and inheritance taxes.

The trouble is, *capital* and *capitalism* are very ill-defined. To speak of *capitalism* is to invite an unconstruct ive shouting match. Capitalism has caused great harm to people and the world! Yes but capitalism is what has made us rich!

A more useful framing is that there have been, and can be, many ways to structure a market economy. When one looks into the mechanisms that have operated in market economies, one can readily identify mechanisms that pump wealth from the 99% to the 1%. One can then think of ways to stop or reverse these flows, so wealth flows more fairly to everyone involved in its generation. It will be much more effective to fix the problems at the source than just to apply traditional retro-active bandaids like taxes.

In my own book *Sack the Economists*, I identified seven fairly obvious such mechanisms. Below is an edited excerpt that summarises mechanisms identified in the course of the book's analyses. (Dean Baker has also made lists, short and longer, which are a little more detailed and only partly overlapping with mine)

Financial market speculation

The financial markets are dominated by speculation and other activities whose sole objective is to siphon wealth from the productive economy. The amount of wealth involved is very large. Some indication might be obtained from the fact that financial sectors in the US and Australia now account for 30–40% of corporate profits. Because corporate profits would be a large fraction of GDP this means a significant fraction of total wealth is pumped to the rich by this mechanism.

Capturing emergent community wealth

This is the wealth that results from the proximity of individual assets and investments. It belongs to no individual, it belongs to the community. In some places some of this wealth is

captured for community use, but very commonly the wealth passes as a windfall to private interests, much of it to developers and landlords. In this way small property holders and renters lose their share of community wealth to those rich enough to be able to capture it.

Interest charged on new money

Our money is created in the course of making loans, and interest is charged as though it were savings, rather than having been created out of nothing. Because we need money for the economy to function, this burden of interest weighs on the whole economy. Banks profit by maximising loans, so the amount of money in circulation is maximised, and this increases the burden on everyone. This is effectively a private tax on the entire economy that pumps wealth to the richest 10 percent. A simple charge for the service of providing a medium of exchange, along with stronger regulation of loans, would be far smaller burden on the economy.

Access to loans

The rich can obtain loans much more easily than the poor. They can invest their loans and become even richer. This mechanism is widely recognised and clearly an important factor, though it is hard to estimate the amounts of wealth involved. Mohammed Yunus demonstrated, with his Grameen Bank in Bangladesh, that it is possible to give loans to the poorest people and so to reduce this iniquity.

The ownership escalator

We use only a restricted range of ownership options in our present economic system. As a result ownership is highly concentrated. Even though public corporations are owned collectively, it is the rich who own shares disproportionately. Even though many people own some shares through retirement funds, the distribution of ownership is still strongly skewed to the rich. Once you gain ownership of significant assets, wealth begins to flow to you. If you are poor and have to rent your accommodation, wealth drains away from you. Owners are on an up escalator. The poor are on a down escalator.

As William Greider observed, the problem is not that capital is privately owned, the problem is that most people don't own any. We already have many forms of ownership that can change this. Ownership can be distributed much more equitably by actively promoting less common forms such as ownership by employees and other stakeholders. Ownership can also be conditional, with time limits and progressive transfers of ownership, or owning buildings but not land, and so on, as discussed earlier.

Corporate welfare

There are many subsidies paid to corporations or rich minorities that benefit the rich at the expense of the poor. Often they harm the environment as well, thus harming everyone. Even a decade ago perverse subsidies amounted to perhaps $2 trillion annually, a considerable fraction of global wealth generation. Subsidies to fossil fuel use amount to perhaps $300 billion globally.

Tax avoidance

This is closely related to corporate welfare, because it is practised mainly by large corporations, particularly transnational corporations. They do this by complex internal transfers of money that exploit loopholes in tax laws, or dif-

ferences in tax systems among nations. They are abetted by a few small nations that charge minimal corporate tax. Such tax havens could be closed down overnight by concerted action of a few rich nations, but those nations' governments are owned by the rich, so it doesn't happen. The proportion of taxes collected from corporations has dropped by about half over the past half century.

This list will not be exhaustive, but it already demonstrates that vast amounts of wealth are transferred to the rich by mechanisms that cannot be justified as the fair operation of markets. Either the markets operate perversely, through the invisible fist instead of the invisible hand, or they have been rigged, with the connivance of compliant legislators. Corporate welfare and much tax avoidance result from explicit interventions. The other mechanisms are due to malfunctioning markets that allow some individuals to exploit an instability, an up escalator, that allows the rich to become richer.

If we simply eliminated the mechanisms that unfairly pump wealth to the rich, our societies would be considerably less unequal. The need for welfare would be greatly reduced. The efficiency of the economy would be increased, because producers would pay closer to the full costs of production, markets would operate more effectively, and costly welfare bureaucracies could be reduced. The dignity and self respect of the less wealthy would not be compromised by having to accept welfare, and by being perpetually robbed and vilified by the greedy. Fixing the problems at their sources would be far more efficient and effective than the various retroactive mechanisms that have been developed through the twentieth century.

Source: Steve Keen's DebtWatch http://www.debtdeflation.com/blogs/2014/04/23/more-effective-remedies-for-inequality-than-pikettys/

Dr Geoff Davies is a Senior Research Fellow at the Australian National University (Institute of Advanced Studies) in Canberra. His latest book Is titled *Sack the Economists*.

Martin Wolf for monetary reform

ERA Review Editor

UK Positive Money's Ben Dyson has recently drawn attention to an article by Martin Wolf, the chief economics commentator at the Financial Times, in an article entitled "Strip private banks of their power to create money": *"Printing counterfeit banknotes is illegal, but creating private money is not. The interdependence between the state and the businesses that can do this is the source of much of the instability of our economies. It could - and should - be terminated."*

FINANCIAL TIMES

April 24, 2014 1:32 pm

Strip private banks of their power to create money

By Martin Wolf Author alerts

The giant hole at the heart of our market economies needs to be plugged

Wolf highlights the fact that the ability of banks to create money requires governments and taxpayers to underwrite the banking system: *"Banking is therefore not a normal market activity, because it provides two linked public goods: money and the payments network. On one side of banks' balance sheets lie risky assets;*

on the other lie liabilities the public thinks safe. This is why central banks act as lenders of last resort and governments provide deposit insurance and equity injections. It is also why banking is heavily regulated. Yet credit cycles are still hugely destabilising."

"What is to be done? A minimum response would leave this industry largely as it is but both tighten regulation and insist that a bigger proportion of the balance sheet be financed with equity or credibly loss-absorbing debt. … A maximum response would be to give the state a monopoly on money creation."

The article then refers to Modernising Money, the book that Dyson published in early 2013, and gives an overview of these proposals (summarised below):

(a) The state, not banks, would create all money. Customers would own the money in transaction accounts (which would never be put at risk), and would pay the banks a fee for providing payments services.

(b) Banks would also offer investment accounts, which fund loans. But banks could only lend money that was actively invested by customers. They would no longer be allowed to create new money out of thin air.

(c) The central bank would create new money as is necessary to promote non-inflationary growth.

(d) Decisions on how much money would be taken by a committee independent of government (much like the Monetary Policy Committee). Finally, new money would be injected into the economy via a) government spending, b) tax cuts, c) to make direct payments to citizens, d) to pay down existing debts – national or public, or e) to make new loans through banks or other lending firms (such as peer to peer business lenders).

Wolf highlights some of the benefits of this reform:

"The transition to a system in which money creation is separated from financial intermediation would be feasible, albeit complex. But it would bring huge advantages. It would be possible to increase the money supply without encouraging people to borrow to the hilt. It would end "too big to fail" in banking. It would also transfer seignorage – the benefits from creating money – to the public. In 2013, for example, sterling M1 (transactions money) was 80 per cent of gross domestic product. If the central bank decided this could grow at 5 per cent a year, the government could run a fiscal deficit of 4 per cent of GDP without borrowing or taxing. The right might decide to cut taxes, the left to raise spending. The choice would be political, as it should be."

He points out only 10% of UK bank lending actually goes to businesses, meaning that restricting the level of bank lending doesn't have to mean that businesses will suffer. (Speculative credit to property bubbles and financial markets could be restricted whilst preserving credit to businesses).

Wolf summarises by saying that:
"Our financial system is so unstable because the state first allowed it to create almost all the money in the economy and was then forced to insure it when performing that function. This is a giant hole at the heart of our market economies. It could be closed by separating the provision of money, rightly a function of the state, from the

provision of finance, a function of the private sector."

Wolf concludes that the although this change won't come about immediately, we should remember the possibility of making these changes, because "When the next crisis comes - and it surely will - we need to be ready."

Source: Positive Money (UK) website http://www.positivemoney.org/2014/04/strip-private-banks-power-create-money-financial-times-martin-wolf-endorses-positive-moneys-proposals-reform/?mc_cid=eea141e381&mc_eid=dece308a49

Human extinction in our lifetime?

Interview with Guy McPherson
ERA Review Editor

A recent TV interview has investigated the idea that only the collapse of Industrial civilization can prevent climate change. Could global warming lead to the destruction of human civilization within just a few decades?

In the RT program *Conversations With Great Minds* there is an interview with Guy McPherson - Professor Emeritus of Natural Resources - Ecology - and Evolutionary Biology at the University of Arizona.

Guy is one of the most influential U.S. experts on global warming, and writes about a variety of climate change-related issues for the *Arctic News* and his own website -- *Nature Bats Last*. In the field of climate science, Guy is best known for his assertion that runaway global warming is already on a path to cause the extinction of the human race - an idea he has written about in his book - *Going Dark*.

Source:
http://www.informationclearinghouse.info/article38208.htm

The folly of exponential growth

Lionel Anet

The subject of the interview with Guy McPherson is what I have feared for the last two decades. Although many people know what exponential growth is, they don't understand its practical implications, or have simply ignored it. It is incredible to get so close to our demise with so few of us being aware of it. That ignorance is due to an education that's geared to a faulty competitive economy, where one must be highly focused and specialised to win. People therefore don't see the combination of a multitude of factors that can escalate a progression in an exponential way, and that way leads to our extermination.

Water lily

French children are told a story in which they imagine having a pond with water lily leaves floating on the surface. The lily population doubles in size every day and if left unchecked will smother the pond in 30 days, killing all the other living things in the water. Day after day the plant seems small and so it is decided to leave it to grow until it half-covers the pond, before cutting it back. They are then asked on what day half-coverage will occur. This is revealed to be the 29th day, and then there will be just one day to save the pond. (From Meadows *et al*. 1972)

Estimates for how much time we have left are more uncertain due to many factors. The main and obvious one is the time lag due to the inertia that water has in changing its temperature. This gives us a faulty sense of security, as the increase due to heat trapping chemicals in the atmosphere may remain and be active for centuries. So we need to consider the effect of

adding more of those chemicals, we must imagining what the planet might be like in a century. This means we are actually increasing the heat trapping on top of that high temperature. A sure way we can kill life without appearing to do so.
This video gives a vivid account of what to expect if we continue to burn fossil fuels.

Lionel Anet is a NSW member of ERA

The gross society

Richard Heinberg

This essay originally appeared within Pacific Standard Magazine

Seeing only its title, a prospective reader might guess this essay is about our nation's epidemic of obesity. Or could it be a sarcastic observation on the evolution of Lyndon Johnson's *Great* Society? Might it be a jeremiad about the *gross* (i.e., offensive and disgusting) ways we waste and over-consume natural resources, or a comment on current television trends? There's plenty to be said on all those scores.

No, the definition of *gross* I have in mind is "exclusive of deductions," as in *gross profits* versus *net profits.* The profits we'll be considering come in the forms not just of money but, more crucially, of energy. Sound boring? Well, you may be surprised.

Here's my thesis: As a society, we are entering the early stages of energy impoverishment. It's hard to overstate just how serious a threat this is to every aspect of our current way of life. But the problem is hidden from view by *gross* oil and natural gas production numbers that look and feel just fine - good enough to crow about.

President Obama did some crowing in his most recent State of the Union address, where he touted "More oil produced at home than we buy from the rest of the world - the first time that's happened in nearly twenty years." It's true: US crude oil production has increased from about 5 million barrels per day to nearly 7.75 mb/d in the past five years (we still import over 7.5 mb/d). And American natural gas production is at an all-time high. Energy problem? What energy problem?

While these gross numbers appear splendid, when you look at *net* things go pear-shaped, as the British say.

Our economy is 100 percent dependent on energy: with more and cheaper energy, the economy booms; with less and costlier energy, the economy wilts. When the electricity grid goes down or the gasoline pumps run dry, the economy simply stops in its tracks.

But the situation is actually a bit more complicated, because *it takes energy to get energy*. It takes diesel fuel to drill oil wells; it takes electricity to build solar panels. The surplus energy - once we have fueled energy production - makes possible all the things people want and need to do. It's *net* energy, not *gross* energy, that does society's work.

Before the advent of fossil fuels,

agriculture was our main energy source, and the average net gain from the work of energy production was minimal. Farmers grew food for people - who did a lot of manual work in those days - and also for horses and oxen, whose muscles provided motive power for farm machinery and for land transport via carts and carriages. Because margins were small, most people had to toil in the fields in order to produce enough surplus to enable a small minority of folks to live in towns and specialize in arts and crafts (including statecraft and soldiery).

In contrast, the early years of the fossil fuel era saw astounding energy profits. Wildcat oil drillers could invest a few thousand dollars in equipment and drilling leases and, if they struck black gold, become millionaires almost overnight. If you want a taste of what that was like, watch the classic 1940 film ***Boom Town***, with Clark Gable and Claudette Colbert.

Huge energy returns on both energy and financial investments in drilling made the fossil fuel revolution the biggest event in economic history. Suddenly society was awash with surplus energy. Cheap energy plus a little invention yielded mechanization. Farming became an increasingly mechanized (i.e., fossil-fueled) occupation, which meant fewer field laborers were needed. People left farms and moved to cities, where they got jobs on powered assembly lines manufacturing an explosively expanding array of consumer goods, including labor-saving (i.e., energy-consuming) home machinery like electric vacuum cleaners and clothes washers. Household machines helped free women to participate in the work force. The middle class mushroomed. Little Henry and Henrietta, whose grandparents spent their lives plowing, harvesting, cooking, and cleaning, could now contemplate careers as biologists, sculptors, heart specialists, bankers, concert violinists, professors of medieval French literature – whatever! Human ambition and aspiration appeared to know no bounds.

Unfortunately, there are a couple of problems with fossil fuels. The first is that they cause climate change and thereby cast a pall over the prospects of civilized human existence on planet Earth - but let's set that irritating thought aside for a moment. The other problem is that these fuels are finite in quantity and of variable quality; we have extracted them using the *low-hanging fruit* principle, going after the highest quality, cheapest-to-produce oil, coal, and natural gas first, and leaving the lower quality, more expensive, and harder-to-extract fuels for later. Now, it's *later*.

It's helpful to visualize this best-first principle by way of a diagram of what geologists call the *resource pyramid.* Extractive industries typically start at the top of the pyramid and work their way down (see fig 1). This was the case historically when coal miners at the beginning of the industrial revolution exploited only the very best coal seams, and it's also true today as drillers in the Bakken oil play in North Dakota concentrate their efforts in core areas within that play where per-well production rates are highest.

We'll never run out of any fossil fuel, in the sense of extracting every last molecule of coal, oil, or gas. Long before we get to that point, we will confront the dreaded double line in the

diagram, labeled “energy in = energy out.” At that stage, it will cost as much energy to find, pump, transport, and process a barrel of oil as the oil’s refined products will yield when burned in even the most perfectly efficient engine (I use oil merely as the most apt example; the same principle applies for coal, natural gas, or any other fossil fuel).

As we approach the energy break-even point, we can expect the requirement for ever-higher levels of investment in exploration and production on the part of the petroleum industry; we can therefore anticipate higher prices for finished fuels. Incidentally, we can also expect more environmental risk and damage from the process of fuel “production” (i.e., extraction and processing), because we will be drilling deeper and going to the ends of the Earth to find the last remaining deposits, and we will be burning ever-dirtier fuels.

Right now that’s exactly what *is* happening.

While America’s current gross oil production numbers appear rosy, from an energy accounting perspective the figures are frightening: energy profit margins are declining fast.

Each year, **a greater percentage of US oil production comes from unconventional sources**—primarily tight oil and deepwater oil. Compared to conventional oil from most onshore, vertical wells, these sources demand much higher capital investment per barrel produced. Tight oil wells typically require directional drilling and hydraulic fracturing (“fracking”), which take lots of money and energy (not to mention water); initial production rates per well are modest, and production from each well tends to decline quickly. Therefore more wells have to be drilled continually in order to maintain a constant rate of flow. This has been called the “Red Queen” syndrome, after a passage in Lewis Carroll’s *Through the Looking Glass*. In the story, the fictional Red Queen runs at top speed but never gets anywhere; she explains to Alice, “It takes all the running you can do, to keep in the same place.”

Similarly, it will soon take all the drilling the industry can do just to keep production in the fracking fields steady. But the plateau won’t last long; as the best drilling areas become saturated with wells and companies are forced toward the periphery of fuel-bearing geological formations, costs will rise and production will fall. When, exactly, will the decline begin? **Probably before the end of this decade**.

Deepwater production is expensive too: it involves operating in miles of ocean water on giant drilling and production rigs. Deepwater drilling is also both environmentally and financially risky, as BP discovered in 2010 in the Gulf of Mexico.

Canada’s tar sands require special energy-intensive processing in order to yield usable fuels. Unless oil prices remain at current stratospheric levels, significant expansion of tar sands operations may be uneconomic.

America is turning increasingly to unconventional oil because conventional sources of petroleum are drying up. The United States is where the oil business started and, in the past century-and-a-half, more oil wells have been drilled here than in the rest of the world’s countries put together. In terms of our resource pyramid diagram, the United States has drilled through the

top “conventional resources” triangle and down to the thick dotted line labeled “price / technology limit.” At this point, significantly new technology is required to extract more oil (of which there is plenty - just look how much of the total pyramid is left!), and this comes at a **higher financial cost not just to the industry**, but ultimately to society as a whole. Yet society cannot afford oil that’s arbitrarily expensive: the “price / technology limit” is moveable up to a point, but we may be reaching the frontiers of affordability.

Lower energy profits from unconventional oil inevitably show up in the financials of oil companies. Between 1998 and 2005, the industry invested $1.5 trillion in exploration and production, and this investment yielded 8.6 million barrels per day in additional world oil production. But between 2005 and 2013, **the industry spent $4 trillion on E&P, yet this more-than-doubled investment produced only 4 mb/d in added production**.

It gets worse: all net new production during the 2005-2013 period was from unconventional sources (primarily tight oil from the US and tar sands from Canada); of the $4 trillion spent since 2005, it took $350 billion to achieve a bump in their production. Subtracting unconventionals from the total, world oil production actually fell by about a million barrels a day during these years. That means the oil industry spent over $3.5 trillion to achieve a *decline* in overall conventional production.

Last year was one of the worst ever for new discoveries, and companies are cutting exploration budgets (if there’s nothing worth finding, why waste money?). A recent Reuters article quoted Tim Dodson, the exploration chief of Statoil, the world’s top conventional explorer: “It is becoming increasingly difficult to find new oil and gas, and in particular new oil. . . . The discoveries tend to be somewhat smaller, more complex, more remote, so it is very difficult to see a reversal of that trend ... **The industry at large will probably struggle going forward with reserve replacement.**”

Here is how energy analyst **Mark Lewis** and US Army lieutenant colonel Daniel L. Davis described the situation in a recent article in the *Financial Times*: “The 2013 [World Energy Outlook, published by the International Energy Agency] has the oil industry’s upstream [capital expenditure] rising by nearly 180 per cent since 2000, but the global oil supply (adjusted for energy content) by only 14 per cent. The most straightforward interpretation of this data is that the economics of oil have become completely dislocated from historic norms since 2000 (and especially since 2005), with the industry investing at exponentially higher rates for increasingly small incremental yields of energy.”

The squeeze is also being felt by the global economy, which has sputtered ever since oil prices began their steep march up to the “new normal” of $100 per barrel (more about this below).

The costs of oil exploration and production are currently rising at about 10.9 percent per year, according to **Steve Kopits of the energy analytics firm Douglas-Westwood**. This is squeezing the industry’s profit margins, since it’s getting ever harder to pass these costs on to consumers.
In 2010, ***The Economist*** magazine discussed rising costs of energy

production, musing that "the direction of change seems clear. If the world were a giant company, its return on capital would be falling.".

Tim Morgan, formerly of the London-based brokerage Tullett Prebon (whose customers consist primarily of investment banks), explored the averaged Energy Return on Energy Investment (EROEI) of global energy sources in one of his company's ***Strategy Insights*** reports, noting: "For 2020, our projected EROEI (of 11.5:1) [would] mean that the share of GDP absorbed by energy costs would have escalated to about 9.6 percent from around 6.7 percent today. Our projections further suggest that energy costs could absorb almost 15 percent of GDP (at an EROEI of 7.7:1) by 2030. . . . [T]he critical relationship between energy production and the energy cost of extraction is now deteriorating so rapidly that the economy as we have known it for more than two centuries is beginning to unravel."

From an energy accounting perspective, the situation is in one respect actually worst in North America - which is deeply ironic: it is here that production has grown most in the past five years, and it's here that the industry is most boastful of its achievements. Yet **the average energy profit ratio for US oil production has fallen from 100:1 to 10:1**, and the downward trend is accelerating as more and more oil comes from tight deposits (shale) and deepwater. Canada's prospects are perhaps even more dismal than those of the US: the tar sands of Alberta have an energy-returned-on-energy-invested
ratio that ranges from 3.2:1 to 5:1.

A five-to-one profit ratio might be spectacular in the financial world, but in energy terms this is alarming. Everything we do in industrial societies - education, health care, research, manufacturing, transportation - uses energy. **Unless our *investment of energy in producing more energy* yields an averaged profit ratio of roughly 10:1 or more**, it may not be possible to maintain an industrial (as opposed to an agrarian) mode of societal organization over the long run.

None of the unconventional sources that the petroleum industry is turning toward (tight oil, tar sands, deepwater) would have been developed absent the context of high oil prices, which deliver more revenue to oil companies; it's those revenues that fund ever-bigger investments in technology.

But older industrial economies like the US and EU tend to stall out if oil costs too much, and that reduces energy demand; this "demand destruction" safety valve has (so far) set a limit on global petroleum prices. **Yet for the major oil companies, prices are currently not high enough to pay for the development of new projects in the Arctic or in ultra-deepwater**; this is another reason the majors are cutting back on exploration investments.

For everyone else, though, oil prices are plenty high. Soaring fuel prices wallop airlines, the tourism industry, and farmers. Even real estate prices can be impacted: as gasoline gets more expensive, the lure of distant suburbs for prospective homebuyers wanes. It's more than mere coincidence that the US housing bubble burst in 2008 just as oil prices hit their all-time high.

Rising gasoline prices (since 2005) have led to a **reduction in the average number of miles traveled by US vehicles annually**, a trend toward **less driving by young people**, and efforts on the part of the auto industry to produce **more fuel-efficient vehicles**. Altogether, **American oil consumption is today roughly 20 percent below what it would have been if growth trends in the previous decades had continued**.

To people concerned about climate change, much of this sounds like good news. Oil companies' spending is up but profits are down. Gasoline is more expensive and consumption has declined. Hooray!

There's just one catch. None of this is happening as a result of long-range, comprehensive planning. And it will take a lot of planning and effort to minimize the human impact of a societal shift from relative energy abundance to relative energy scarcity. In fact, there is virtually no discussion occurring among officials about the larger economic implications of declining energy returns on investment. Indeed, rather than soberly assessing the situation and its imminent economic challenges, our policy makers are stuck in a state of public relations-induced euphoria, high on temporarily spiking *gross* US oil and gas production numbers.

The obvious solution to declining fossil fuel returns on investment is to transition to alternative energy sources as quickly as possible. We'll have to do this anyway to address the climate crisis. But from an energy accounting point of view, this may not offer much help. **Renewable energy sources like solar and wind have characteristics very different from those of fossil fuels**: the former are intermittent, while the latter are available on demand. Solar and wind can't affordably power airliners or 18-wheel trucks. Moreover, many renewable energy sources have a relatively low energy profit ratio.

One of the indicators of low or declining energy returns on energy investment is a greater requirement for human labor in the energy production process. In an economy suffering from high unemployment, this may seem like a boon. Indeed, **here is an article that touts solar energy as job creator**, employing more people than the coal and oil industries put together (even though it produces far less energy for society). Yes, jobs are good. But what would happen if we went all the way back to the average energy returns-on-investment of agrarian times?

There'd certainly be plenty of work needing to be done. But we would be living in a society very different from the one we are accustomed to, one in which most people are full-time energy producers and society is able to support relatively few specialists in other activities. Granted, that's probably an exaggeration of our real prospects -- at least some renewable energy sources can give us higher returns than were common in the agrarian era. However, they won't power a rerun of *Dallas*. This will be a simpler, slower, and poorer economy.

If our economy runs on energy, and our energy prospects are gloomy, how is it that the economy is *recovering*?

The simplest answer is, *it's not* - except as measured by a few misleading gross statistics. Each month the Bureau of Labor Statistics releases figures for new jobs created, and the numbers

look relatively good at first glance (175,000 net new jobs for February 2014). But most of these new jobs pay less than jobs that were lost in recent years. And unemployment statistics don't include people who've given up looking for work. **Labor force participation rates are at the lowest level in 35 years**.

All told, according to a recent Gallup poll, **more Americans say they are worse off today than they were a year ago** (as opposed to those who say their situation has improved).

Claims of economic recovery fixate primarily on one number: Gross Domestic Product, or GDP. That number is going up, albeit at an anemic pace in comparison with rates common in the 20th century; hence, the economy is said to be growing. But what does this really mean? When GDP rises, that indicates more money is flowing through the economy. Typically, a higher GDP equates to more consumption of goods and services, and therefore more jobs. What's not to like about that?

A couple of things. First, there are ways of making GDP grow that don't actually improve people's lives. Economist Herman Daly calls this "uneconomic growth." For example, if we spend money on rebuilding after a natural disaster, or on prisons or armaments or cancer treatment, GDP rises. But who wants more natural disasters, crime, wars, or cancer? Historically, the burning of ever more fossil fuels was closely tied to GDP expansion, but now we face the prospect of devastating climate change if we continue increasing our burn rate. To the extent GDP growth is based on fossil fuel consumption, when GDP goes up we're actually worse off because of it. Altogether, *Gross* Domestic Product does a really bad job of capturing how our economy is doing on a *net* basis. In fact, **Daly figures that just about all our current GDP growth is uneconomic**.

Second, a growing money supply (which is implied by GDP growth) depends upon the expansion of credit; another way to say this is: a rising GDP (in any country with a floating exchange rate) entails increasing levels of outstanding debt. **Historical statistics bear this out**. But is any society able to expand its debt endlessly?

If there were indeed limits to a country's ability to perpetually grow GDP by increasing its total debt (government plus private), a warning sign would likely come in the form of a trend toward diminishing GDP returns on each new unit of credit created. Bingo: that's exactly what we've been seeing in the US in recent years. Back in the 1960s, each dollar of increase in total US debt was reflected in nearly a dollar of rise in GDP. By 2000, each new dollar of debt corresponded with only $.20 of GDP growth. **The trend line will reach zero in about 2016**.

Meanwhile, it seems that Americans have taken on about as much household debt as they can manage, as rates of consumer borrowing have been stuck in neutral since the start of the Great Recession. To keep total debt growing (and the economy expanding, if only statistically), the Federal Reserve has kept interest rates low by creating up to $85 billion per month through a mere adjustment of its ledgers (yes, it can do that); it uses the money to buy Treasury bills (US government debt) from Wall Street

banks. When interest rates are low, people find it easier to buy houses and cars (hence the recent rise in house prices and the auto industry's rebound); it also makes it cheaper for the government to borrow - and, in case you haven't noticed, the federal government has borrowed a lot lately.

The Fed's Quantitative Easing (QE) program props up the banks, the auto companies, the housing market, and the Treasury. But, with overall consumer spending still anemic, the trillions of dollars the Fed has created have generally not been loaned out to households and small businesses; instead, they've simply pooled up in the big banks. **This is money that's constantly prowling for significant financial returns, nearly all of which go to the "one percenters."** Fed policy has thus generated a stock market bubble, as well as a bubble of investments in emerging markets, and **these can only continue to inflate for as long as QE persists**.

The obvious way to keep these bubbles from growing and eventually bursting (with attendant financial toxicity spilling over into the rest of the economy) is to stop QE. But doing that will undermine the "recovery," such as it is, and might even send the economy careening into depression. The Fed's solution to this "damned if you do, damned if you don't" quandary is to "taper" QE, reducing it gradually over time. However, this doesn't really solve anything; it's just a way to delay and pretend.

With money as with energy, we are doing extremely well at keeping up appearances by characterizing our situation with a few cherry-picked numbers. But behind the jolly statistics lurks a menacing reality. Collectively, we're like a dietician who has adopted the attitude: *the more you weigh, the healthier you are!* How gross would that be?

The world is changing. Cheap, high-EROEI energy and genuine economic growth are disappearing. Rather than recognizing the fact, we hide it from ourselves with misleading figures. All that this accomplishes is to make it harder to adapt to our new reality.

The irony is, if we recognized the trends and did a little planning, there could be an upside to all of this. We've become over-specialized anyway. We teach our kids to operate machines so sophisticated that almost no one can build one from scratch, but not how to cook, sew, repair broken tools, or grow food. **We seem to be less happy year by year**. We're overcrowded, and **continuing population growth only makes matters worse**. Why not encourage family planning instead? **Studies suggest we could dial back on consumption and be more satisfied with our lives**.

What would the world look and feel like if mankind deliberately and intelligently nudged the brakes on material consum ption, reduced our energy throughput, and re-learned some general skills? Quite a few people have already done the relevant experiment. Take a virtual tour of **Dancing Rabbit ecovillage** in northeast Missouri here, or **Lakabe in northern Spain here**. But you don't have to move to an eco-village to join in the fun; thousands of **Transition** initiatives exist worldwide running essentially the same experiment in ordinary towns and cities, just not so intensively. Take a look at **www.Resilience.org** any day of the week to see reports on these experiments, or tips on what you could

do to adapt more successfully to our new economic reality.

All of these efforts have a couple of things in common: first, they entail a lot of hard work and (according to what I hear) yield considerable satisfaction. Second, they are self-organized and self-directed, not funded or overseen by government.

The latter point is crucial - not because government is inherently wicked, but because it's just not likely to be of much help in present circumstances.

That's because **our political system is currently too broken to grasp the nature of the problems facing us.** Which is unfortunate, because even a little large-scale planning and support could help; without it, we can be sure the transition will be more chaotic than necessary, and a lot of people will be hurt needlessly.

Quite simply, we must learn to be successfully and happily poorer. For people in wealthy industrialized countries, this requires a major adjustment in thinking. When it comes to energy,

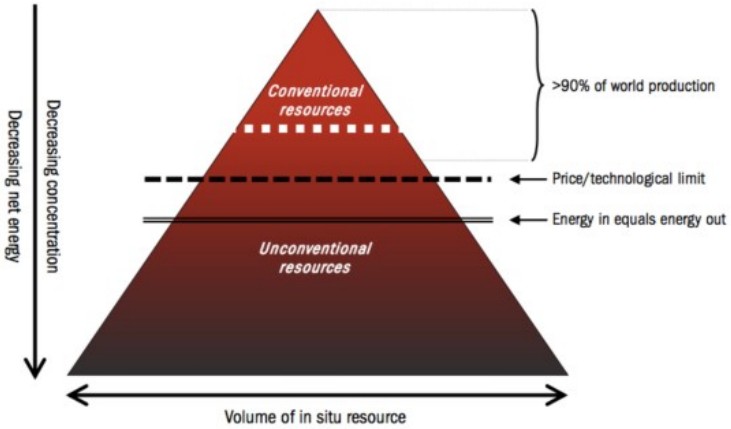

Fig 1: The resource Pyramid

we have deluded ourselves into believing that gross is the same as net. In the early days of fossil fuels, it very nearly was. But now we have to go back to thinking the way people did when energy profit margins were smaller. We must learn to operate within budgets and limits.

This means decentralization, simplification, and localization. Becoming less reliant on long-term debt, paying as we go. It means living closer to the ground, learning general skills, and keeping a hand in basic productive activities like

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growing food.

Think of our future as the Lean Society. We can make this transition successfully, if not happily, if enough of us embrace Lean Society thinking and habits. But things likely won't go well at all if we continue to hide reality from ourselves with gross numbers that delay our adaptation to accelerating, inevitable trends.

Source: Richard Heinberg Museletter #263 http://richardheinberg.com/museletter-263-the-gross-society