



THE ECONOMICS OF PROSPERITY

*Our present economic/financial system doesn't work.
It is open to, and frequently subjected to extreme abuse,
and it fails to deliver the prosperity of which it is capable.
We need to fix it.*

Poverty is not the natural order of things. We have resources, inventive minds and manual skills, all that is needed to produce prosperity on a world scale. To enhance this creative potential through collaboration and trade we have developed a complex web of employment, production, distribution, pay and prices. But this process is dependent entirely on the economic/financial infrastructure, and right now it's a disaster – from developed-world crashes to third-world multi-million percent inflation. Why? Because we rely on an antiquated system outdated by a couple of hundred years, wide open to abuse and corruption. Economists like to shroud finance in complex formulas and unintelligible jargon. But economics is not rocket science, it's common sense and human nature. It can be comprehended, and it can be made to work. Two major issues require review and revision: managing credit, and defining value. But let's start with basics.

THE BASICS	CREDIT MANAGEMENT	STABILIZING VALUE
<ol style="list-style-type: none"> 1. The Division of Labour 2. Establishing Value 3. Money & Credit 4. What is Capitalism 	<ol style="list-style-type: none"> 1. Regulating Credit 2. Misuse & Waste 3. Three Faces of Banking 4. Development Banking 	<ol style="list-style-type: none"> 1. The Anatomy of Inflation 2. Full Employment 3. Prosperity = Productivity 4. Property Values

THE BASICS

1. Trade and the Division of Labour

Let's begin at the beginning. And the beginning is the *division of labour*. Without the division of labour there'd be no need for pay, prices or money. And *economics* would be a simple matter of personal household management – which is precisely what the word means in its original Greek derivation.

Imagine that you live alone in the wilderness; that you're totally self-sufficient, producing for yourself everything you need in life. You grow what you need to eat, your house is built of wood from the forest, the dead logs supply your fuel in winter, your own grain gives you flour for bread, you weave your own clothing materials from your own flax and cotton. In such circumstances you would have no need for trade or money, and the whole science of economics would be irrelevant.

The *division of labour* is the process whereby each of us develops a particular trade or specialty. We produce more of a product or commodity than we personally need, then trade our surplus with others. Why bother? Specialization allows the amateur woodworker, for example, to become a full-time professional, buying or making special tools, developing skills, and thus being able to make better goods more cheaply. This is called *productivity* and it is very important. Increasing productivity is the art of making better goods tomorrow with less work than it took yesterday. This applies equally to jobs we do at home, or to complex factory production systems. The result is the same: more and/or better goods with less work. Increasing productivity is what makes an individual, a region or a nation prosperous. And specialization is the best way to increase productivity.

So. What can I specialize in? I find that I have good soil and sunny conditions which produce really good tomatoes. I produce tomatoes in quantity, far more than I need for myself. Then I have to *trade* them with other people who are also producing a surplus of some different product or commodity. That means taking my tomatoes into town to trade them. Market places for this purpose can be found everywhere, in every economy from primitive to sophisticated.

Now comes the fun of trading. Or is it fun? In fact it can be quite a problem. Or rather, two problems. The first is that we need to establish some kind of common **value** for the products we want to trade.

THE BASICS

2. Establishing VALUE for goods we want to trade

I have tomatoes, I want bread. Fine. And I happen to find a baker who bakes good bread and loves tomatoes. But how do I decide how many tomatoes he gets for his loaf of bread? At the next stall a potter with some fine plates to trade is talking to a woodworker – the potter wants a table. But how many of the potter's plates is a table worth?

How, in other words, do we establish **value**? How would you decide how many plates a table is worth?

The answer comes in two parts: the *Constituent Cost*, and the *Supply/Demand Modification*.

The *Constituent Cost* is the basic cost of labour, expertise, investment and materials. In this simple market-trading situation which we envisage at the moment, the crafts are still relatively simple, and anyone can turn his or her hand to almost anything if needed. Thus each person knows how much work and expertise is involved in the other's product, and it is on this estimation that a trade would be based. Six of these plates require the same amount of time and expertise as the table, and that is the basis of the trade. Labour, in other words, is the basis for evaluation. Labour in terms of time, experience, effort, expertise, and all its other facets. Though the evaluation process is more complex today, every factory manager must still be aware of his product's total unit constituent cost including bought-in materials, added labour, investment write-off, and general overhead expenses.

The second factor involved in assessing value is *Supply and Demand*. Whatever the constituent cost may be, you will not sell your product if there is no demand for it. If demand is slack you may be forced to sell at a loss, or at least reward your own labour less handsomely. On the other hand, if there is a great demand for your product and no competition, you can afford to ask a bit extra over and above the constituent cost. Your reputation may suffer amongst your customers, with ominous rumblings of "taking advantage"... but your wallet will be well-filled. Scarcity in times of war can create price-rises on a monumental scale; this is generally declared illegal, and trading at inflated prices is known as a "black market".

In the days when trade involved simple crafts, value was based on labour-content which could readily be estimated by the buyer. But since the coming of the industrial revolution with its increasing complexities, the concept of "basic value" originally tied to labour has now been lost.

True, every factory owner must still be aware of his product's total unit constituent cost including bought-in materials, added labour, investment write-off, and general overhead expenses. But it's not that simple. The payment for labour is flexible, so also is the profit and the market price.

In reality, pay, profits and prices are totally baseless, a matter of how much you can get, or how much you can get away with. It's all a matter of on-going dispute, free-floating with no basic definition or foundation. And since money has meaning only in terms of how much you get and what you can buy with it, that's free-floating too, without any basic, defined value. Our goods and services, our work as employees, and our monetary unit have no defined value. It's something we never really think about, but it's perhaps the most significant cause of monetary and social instability. We'll return to it later.

THE BASICS

3. Money, or Medium of Exchange

The second problem in the trading process is that we haven't yet “invented” money, so we, the would-be traders, are dealing with one another in direct *barter*. Bartering means that you swap directly, product for product or service. I have tomatoes for sale. I need bread – no problem, there are plenty of bakers offering their selections.

The major difficulty with bartering goods for goods is the need to find someone who exactly mirrors your own requirements. I have tomatoes and need bread. So I have to find a baker who has bread and wants tomatoes. A tedious process to say the least. So how do we get around it?

We use money, or in broader terms, a Medium of Exchange.

The earliest kind of money was a *commodity* used as a universal exchange medium. Gold and silver were always popular; rare seashells too. In war-torn Vienna of the late 1940s people used packets of coffee. Today we rely largely on the electronic transfer of credit and debit between computerized accounts.

As long as we're using a commodity, its essential features are: it must be portable, durable, useful, preferably not too common, and widely acceptable. With an exchange medium of this kind, trade suddenly becomes much easier. I bring my tomatoes to market, and sell a few for silver or shells or money or whatever it is we're using. Then I can take my silver or shells or money and find a baker who has the bread I want – and no problem if he hates tomatoes!

An Exchange Medium of whatever kind allows the trade to be broken as between buyer and seller. You don't need to find someone who has what you want, and wants what you've got. You now have the ability to “break” the trade in terms of **person or place**. You can sell to one person in one place and buy from another somewhere else; you don't have to tie the buying and the selling into one transaction.

You can also use the trading commodity to break the trade in terms of **time**. You can sell your goods today, then come back next week and buy what you need. That's **saving**.

Because the trading commodity is durable and portable, you can take it home and store it. People like to have a store of value, something saved “for a rainy day”. Many people in India and Africa store their wealth in ornaments made of precious metals which they will often wear every day, or display on special occasions.

The problem here is that saving can unbalance the market. Suppose a lot of people decide to increase their savings. They bring their goods into market, sell them for money, but instead of buying other goods in exchange, they simply go home with their saved money. So the market will be left with a surplus of goods, because a lot of people have brought goods into town and sold them, but haven't taken anything away in exchange.

There is a way around this problem – it's called investment. Investment is the opposite of saving.

When we *save*, we produce and sell goods now, then we buy and consume later.
When we *invest*, we buy and consume now, then produce and sell later.

If the market is to remain in balance, it is important that the investment potential created by saving should be put to good use. So let's see what we can do with it.

We have here a young lad who is building a new machine of his own invention which will greatly simplify farm work. He needs construction materials, and food to sustain him until his machine is ready for sale. He needs to borrow and invest. He wants to buy food and materials now, then bring his machine to market later. Actually he plans to have it ready for the coming harvest time.

Or take the case of a farmer who has “green fingers” and great soil. He wants to buy seed. He knows that he will have some fine crops to sell... in six months' time. But not only does he need money for seed, he understandably doesn't want to wait six months for his next meal. He too wants to **borrow and invest**. He wants to buy and consume now, to produce and sell in six months.

Saving represents a significant investment potential which should not go unused. It is important at all times to make good use of this valuable and limited commodity.

It is also important that saving and investment should broadly balance one another. If everybody brings goods to market but doesn't want to buy because they prefer to save, the goods won't sell.

On the other hand, if everybody wants to borrow but won't be producing anything for six months, a lot of people will be wanting goods which just aren't there. This is what happened in the Soviet Union during its socialist days. The government invested heavily in infrastructure like power generating, heavy machinery and so on, while ignoring the needs of agriculture and consumer goods. Anyone who toured the USSR in the socialist times will recall seeing supermarkets with long rows of empty shelves. Workers were coming home with pay packets – and nothing to spend their money on.

And so we have two uses for money. We can use it for day-to-day trade. And it can also be used for saving and investment. Let's look more closely at this process.

Some people who have gold or money saved will *invest* it directly in what looks like a profitable enterprise. But many others through the ages have preferred to deposit their gold with a gold-store, for which they were given certificates of deposit.

These certificates, when issued by a reputable gold-store establishment, were tradable as money, and were to become what we would call Bank Notes. They could be loaned to potential investors with projects offering the prospect of a profit.

The gold-storers, who later became the bankers, soon found that it would be extremely unlikely for *all* of their clients to demand *all* of their gold at any one time, and seeing an opportunity, they responded in a way which might well appear deceitful. They created Bank Notes over and above the amount of gold they had in store, and lent these Bank Notes to potential investors. Of course that meant that there were now more of the bank's "gold receipts" in circulation than there was gold in the bank, and a "run on the bank", with everybody at the same time wanting gold in exchange for their bank notes, would break the bank. Loss of faith in a bank, or indeed in the banking system generally, resulting in runs on the banks happened frequently in the early days of banking, an occurrence revisited with a vengeance in 2008.

However the issuance of Bank Notes not fully backed by gold or other solid reserves was a useful, indeed an essential practice, if the availability of money for trade and investment was to keep pace with a rapidly industrializing world.

Money is needed to finance investment in new or expanding industries, and for trade and commerce. We depend on money both for trade and for saving/investment. As production and trade increase, so must our supply of money. If we tie our money to a commodity like gold which is in limited supply, then money will also be in limited supply, and will soon become inadequate to finance growing national and global trade.

Today we have what is known as "fractional reserve" banking, which allows banks to "create" credit up to an amount which is a multiple of their reserves. Indeed credit – a simple entry in an account book or in a computer record – is now taking over from physical money in the sense of pieces of paper and coinage.

But our modern credit system has become almost too easy. Lacking discipline, banks indulge in risky speculation in complex financial instruments using their reserves and customers' deposits, and frequent scandals have resulted. Worse, banks lack both the incentive and the direction necessary to foster growth and prosperity in a modern economy. Investment credit has an enormous potential to maximize employment, productivity and thus prosperity, yet it is currently both under-used, and mis-used.

We need a credit system. For day-to-day transactions, and for saving-investment. The system should be rock-solid and reliable, and should do its job of assisting growth potential. But the events of 2008 dramatically confirmed the doubts many observers have long expressed. And many who previously held the banking system in full confidence must now be asking: is our present banking system the best we can do – or even – is it good enough? The near collapse of the world's major financial systems, saved only by massive government intervention, would indicate that the answer is clearly "no".

Banks are private companies, in business to make a profit. They are permitted by government and central bank regulation to create credit up to a specified proportion of their assets. But no qualitative conditions are specified, leaving banks free to gamble in search of profits – indeed they are encouraged to do so to satisfy their directors and shareholders. Nor are their gambling activities limited by their assets.

Margin trading is commonplace – buy shares or currency futures or commodity futures today on the presumption (= in the hope) that they will be higher in two days' time, using money you haven't got because you are normally allowed two days to settle for the original purchase.

The larger the banks, the larger and more complex the trades and the risks. And when major banking groups have several thousand employees, individuals or small departments can risk the bank's assets in trades the complexity of which their executives don't even know about and probably wouldn't understand if they did.

Individual crooks within the banking system aside, banks need profits to please the stock market. And how does the stock market reward them? By shaking the whole financial system with the wild trading fluctuations seen in 2008 the moment any degree of financial uncertainty appears. Yes, banks found themselves in trouble mainly of their own making through complex and irresponsible trading. But the "panic" and "turmoil" were in the stock markets. Why the wild gyrations? Stock market activities are to a large extent motivated by greed and fear. Sellers fear losses, the "bottom fishers" or bargain hunters come in when prices are low, then pull out quickly making a fast profit. Though some traders may wear faces of panic, many others are doing very nicely thank you.

And this is our financial system.

Do we need banks which are solely responsible to their shareholders? Do we need shareholders? Or is there a better way? Corporate institutions licensed to create credit within specified limits, with clearly defined and closely supervised guidelines, their profits, the pay of their staff and the prices charged to customers subject to overall guidelines, could better serve the day-to-day needs of customers and contribute constructively to the needs of business and industry. We need a credit system. And we need it to work.

THE BASICS

4. What is Capitalism?

For Karl Marx, Capitalism was the Devil's Instrument Incarnate. But in fact neither Marx nor anyone else can do without it in its simplest sense. In reality Marx was more concerned with remuneration relativities – the sharing of profits between the owners of the capital equipment and the workers who operated it.

The essence of capitalism lies in the fact that by pausing in the production of goods for immediate consumption and giving time over to the production of simple tools or machinery, once completed those tools and machines can continue production with much greater efficiency, yielding more and better consumable results faster than the previous manual production.

As an example, look at the early pioneering days in the United States. A family might be engaged in farming their own food, and building or improving their family home. One young son of the family is beavering away in the barn on some new “invention” – to the slight disapproval of his family who would rather he joined them improving the home before winter. When the young lad has finished and unveils his new “device” feelings are still mixed. But come next harvest when his threshing machine is put to use, doing the work in far less time and with much less manual effort than before, he’s the family hero.

His threshing machine is “capital”; he forfeited work on the house which could have been of immediate benefit, working on a machine which would give longterm benefit in terms of higher productivity.

So if that’s “capital”, what was Karl Marx’s problem? Not the fact of capital equipment which could and can increase productivity thus in turn producing better goods at less cost. Marx’s problem lay in the relative distribution of proceeds from sales as between capital owners and workers. This is still a bone of contention today. In autumn of 2008 for example, Boeing aircraft workers went on a prolonged strike. One major issue was that their pay was not keeping pace with inflation – while the bosses were getting handsome raises. It’s a familiar story!

The development of capitalism has taken place, so far, in four stages: private, joint stock, casino, and whiz kid. Let’s look at each one in turn.

When capitalism began, way back in the mists of history, primitive man created the stone axe, tools and simple machines which were personally developed and owned, much like the example of the threshing machine described above.

Capitalism really took off in the mid-1800s with the invention of the Joint Stock Company. The idea was to sell shares in a company so that many small savers could collectively provide increased investment in machinery, stocks and equipment, and then share in the company’s hoped-for success.

This worked well in its early stages simply because it was conducted properly and responsibly. Big companies were not that many, and investors tended to buy stocks in companies within their own national borders. One investigated the company, read its financial reports, and took shares in that company because it appeared to be sound and well-managed. The anticipation was that the company, and thus one’s shares in it, would prosper, enhancing the value of its capital equipment, and paying regular dividends to its investors from the company’s profits. Purchasing a company’s shares was based on research, and investment in the company was a token of longterm confidence.

But with the early 1900s things took a different turn as capitalism moved into its third “casino” phase. Government stocks and bank accounts were boring, paying steady but paltry dividends. People wanted something more spectacular in terms of reward for their savings.

So the stock market gained rapidly in popularity as investors large and small piled in. And on what did they base their choices of companies and shares? Research, study of annual reports, recommendations of informed brokers? No. They saw particular stocks going up so they bought. Simple, and effective – for a time. But many popular stocks became vastly over-valued, which is to say very specifically, that they were valued more highly than their prospects and dividends warranted. But then who cared or even knew about company reports and prospects? They were boring boring boring, something the smart cocktail set, the flappers, the young men breezing into the Drones’ Club for billiards and champagne lunch could hardly be bothered with. This was the gay twenties, when those with money assumed a natural right to have it grow without any effort on their part.

Aside from inflated stock prices, an unregulated market at that time was open to fraud and scurrilous dealers who began offering shares in non-existent mining operations in remote parts of the globe. But never mind what it was, if the price was going up, buy buy buy. Of course a crash was inevitable, and it came with a vengeance. The Wall Street Crash of 1929 with its disastrous after-effects is well documented.

Did anybody learn any lessons? In the late 1980s Japanese stocks and property grew into one of the biggest bubbles the world has known. The Nikkei Stock Index just went up and up. You could walk along a street in Tokyo and see screens in shop windows – each one you passed showing the Nikkei higher than the last one. Japanese Warrants, a highly geared method of investing in stocks, were regularly yielding their fortunate purchasers 150% gain per year.

Again, the crash was dramatic and well documented. Almost 20 years later Japan had still not recovered its economic equanimity.

So much for the (very much on-going) “casino” phase of capitalism.

The next and most recent phase of capitalism was to introduce further excitement into investing, with corresponding risks and opportunities for profit or loss on a previously unimagined scale. This is the “whiz kid” phase of shorts and longs, derivatives, leveraging, and more recently, mortgage-backed securities. This is a world in which bankers stand back in wonderment as their young fast-dealing employees perform complex monetary convolutions with the banks’ money, details of which the directors are hardly aware and which they wouldn’t understand even if they were.

Let’s look briefly at some of these fancy devices. Leveraging means you don’t just invest money you have, you borrow 100 times its value, so when you clinch a successful deal your profits are 100 times greater. Of course if the deal doesn’t work you’re 100 times worse off.

Another more recent invention is mortgage-backed securities. Instead of your local bank giving you a mortgage and keeping the deeds of your house, the bank, or perhaps a shady mortgage salesman, fixes you up with a deal you probably can’t afford. But never mind.

A whole raft of mortgages are then thrown together into one big package, which in turn is chopped up into tiny pieces and sold to investors and investment funds around the globe. The risk is spread so widely and so thinly, the inventors led the market to believe, that if anything goes wrong and any mortgages should default, no one will feel any pain. In the event however, the bad mortgages proved a collective virus, and when they turned sour through defaults, spread their disease around the globe, and commentators with an eye to a catchy turn of phrase coined the term “toxic” to describe these infected investments.

Or take derivatives. Derivatives are a way of investing, not in a real asset, but in assets which derive their value indirectly from something else – for example, investing, or rather speculating, in commodity futures, rather than commodities themselves. The commodity futures market is open and regulated. But as of 2008 the newer derivatives have not been traded on an exchange and there are no transparent records of who is trading what. More importantly, there is no clearing house holding collateral to guarantee trades and settle bad deals. This area, which traders refer to as “darker markets”, accounted for millions of private trades involving many of Wall Street’s top firms. It became a house of cards, requiring only a few bad and unsupported deals to set off a train of disaster. And it took time to discover who were the losers.

The 2008 financial disaster was often referred to as a “banking crisis”, but the intensification of the crisis came not from the banks serving their customers through standard banking practices, but from their finance arms, their “off-balance-sheet vehicles” through which they gambled – with very high stakes involving highly geared derivatives. American investment guru Warren Buffet once remarked that derivatives were “financial weapons of mass destruction”. He was proved devastatingly right in 2008.

The four phases of capitalism: private, joint stock, casino, and whiz kid. What next one wonders?

Or perhaps it’s time to call a halt to the abuses of our financial system and limit ourselves to employing its potential carefully and conservatively for the purposes it originally served quite well: facilitating trade, and investment into profitable enterprises. Abuse of the system, something Marx could probably never have visualized, has become a major issue, so much so that unless stricter rules regarding the management of money in its various institutions are put into place fairly rapidly our whole financial system may become unworkable. And if you think that a well-maintained road system, a local fire service and efficient garbage disposal are important elements in a society’s infrastructure, they pale into insignificance beside the most vital infra-structural facility of all: our monetary system.

CREDIT MANAGEMENT

1. The Regulation of Credit

The most important element in any economy is finance, money or credit. Without what may broadly be called a monetary system, an economy is reduced to barter. It is vital to ensure, first and foremost, that the operation of the monetary system is honest and effective.

In order to exchange goods and services without the tedium of direct barter, society needs an exchange medium. If there is no exchange medium trade becomes almost impossible. If there is a shortage of exchange medium trade is slow. It is therefore important that whatever medium is used, there should be sufficient available to satisfy the needs of trade and investment.

The exchange medium used in earlier times was a real commodity such as seashells, gold or coffee. In today's near-cashless society the exchange medium is the credit facility.

Simply stated, the Commercial, or Main Street banks themselves create credit by making loans to their customers; the loans are eventually repaid, and more loans are made. It is a continuous-flow process, as credit flows out and back, and is then recycled out again. It is this revolving flow of credit which finances the entire economy, buying and selling, earnings and savings, longterm investments and retirement pensions. The Commercial Banks are private corporations, whose sole objective in present circumstances is to make a profit for their shareholders.

The Nation's Central Bank attempts to regulate the total quantity of credit in circulation so that it satisfies the needs of the economy in its current or potential level of activity. If there is insufficient credit available to finance the economy's needs, the Central Bank lowers interest rates, thus encouraging business investment and personal credit-spending. Excessive liquidity can cause overheating and inflation, and to slow down the level of economic activity the Central Bank raises interest rates, thus slowing the pace of business investment and personal credit-spending.

The Central Bank, in conjunction with government economic policy, regulates the quantity of credit flowing through the economy. But the actual translation of a potential credit facility into real industrial and consumer loans is left wholly to the discretion of the private Commercial Banks, whose motives are solely shareholder-profit oriented.

Government regulatory involvement in the Monetary System, the revolving flow of credit which empowers investment and lubricates the entire industrial and commercial machinery of the nation, is concerned solely with the *quantitative* issue of how much credit is available in the system at any given time, and exhibits no interest in, nor exercises much influence over, the selective or *qualitative* issue of how the available credit is used.

CREDIT MANAGEMENT

2. Misuse and wasted potential

Just as governments still carry a residual aura of absolute monarchs ruling by divine right, bankers too like to maintain a residual mystique harking back to the days when their vaults were filled with gold, and major banking groups even printed their own banknotes. The reality today however is quite different. Today's Commercial Banks are creating credit within the overall framework of, and under the ultimate control of, the national monetary system. They are simply acting as agents handling a national resource. It is a resource of extensive proportions and of vital import to the economy both nationally and at local community level. And yet this resource of the nation, this *System-generated Credit* is created and channeled by the commercial banking sector with little reference to the overall needs of the economy and frequently with insufficient financial responsibility.

Bankers are, in reality, wholesalers and retailers, providing credit to consumers by drawing from a national infrastructural asset deriving its origin, authority and credibility from government.

This national infrastructural asset of available credit is limited in quantity and carries enormous potential for employment, production and productivity – and thus prosperity.

Overall quantity is regulated by government and central banks. But there is no regulation over *quality* of use.

How do banks handle this limited and valuable resource? Responsibly, realizing its maximum prosperity-creating potential?

Absolutely not.

Consider just a few examples of banking irresponsibility.

Banks encourage home-owners to indulge in shopping sprees by taking out second and third mortgages “secured” by clearly inflated market values. Yes, advertisements on American radio have promoted just such offers.

Credit Card departments of banking institutions advertise actively for business – “no credit checks, instant acceptance guaranteed”. Why such rash promises? Surely there will be defaults. Yes of course there will be. But there will also be the “poor but honest” who maximize their card debt then have to pay interest at an annual 19%.

In the pursuance of profits, major banks take substantial risks in financial speculation on a huge scale, or at local level, in unproductive ventures operated by relatives or thinly disguised associated companies. The history of banking provides numerous references to major banking scandals where banks have made substantial loans to dubious real estate companies, or, more recently, where banks have played the foreign currency markets

using complex high-risk gearing techniques. The situation remains unchanged, and a new major banking scandal can break at any time. The complete collapse in 2008 of major banking, investment and insurance institutions can leave no doubt in anyone's mind: Clearly there is insufficient control over the commercial banks' investment activities.

Traditional banking practice is founded on "reserves", with loans based on and securitized by those reserves. The philosophy is that once you've got reserves, you can gamble, speculate, make dubious property loans... whatever you like. But experiences in 2008 have proved conclusively that banks' "assets" as security are a fantasy, a foundation of sand on which they construct a house of cards. Reserves are in effect insurance, insurance against bad loans. But as any insurance assessor knows only too well, insurance must be weighed against risk, and bankers' gambles and their investment "devices" have become so complex that risk is almost impossible to estimate.

In the autumn 2008 global financial storm, UBS, Switzerland's biggest bank, got itself into serious trouble. Not only was the bank gambling wildly, it also grossly underestimated the risks it was taking. Before the beginning of the crisis, UBS calculated its credit risk at SFr 800 million. In the event it had to write down SFr 40 *billion* – that's 50 times more. The government had to step in and save the bank by putting in \$5.3 billion to take a 9.3 percent ownership in the bank. The "reserve of last resort", it turns out, is the unfortunate taxpayer.

It goes without saying that the current banking practice of gambling its reserves for profit has to stop. Reserves which they consider their own are ultimately guaranteed by government and central bank, and should not be viewed as casino chips.

But to promote employment and growth we need to go much farther, and completely revise – indeed *reverse* our banking philosophy, moving from asset-backed securitization to project-based securitization. In other words, the security of a loan must be based on the validity and on-going monitoring of the investment project itself. Banking philosophy needs to look forward to the investment project as security, not backwards to its reserves. Reserves are only as good as the project they are supposed to guarantee.

Our entire financial system is based on *System-generated Credit*, a national resource and not the private property of the banks – a fact totally unacceptable to the banking community, yet brought home with devastating clarity in the autumn of 2008, when the worldwide financial crisis prompted first, guarantees of government and central bank support in Ireland then in the USA, followed by what amounted to partial nationalization of several major banks in Britain as the government took shares in the banks' equity and imposed stricter standards and controls – an example subsequently copied by the USA and some European administrations. The fact is now clearly and transparently established: a nation's credit flow is a national resource, and government is the banker of last resort.

Once this is recognized and accepted it becomes a matter of importance to consider how this vital – and limited – resource can be used *safely*, and to the greatest benefit of the overall economy.

CREDIT MANAGEMENT

3. Three Faces of Banking

The basic requirement of a nation's financial infrastructure caters for day-to-day banking matters such as current accounts, locally financed mortgages, and loans for big-ticket consumer purchases, all of which are necessary functions. This is Utility Banking. Clearly, appropriate controls and guidelines must be established to ensure that the resources of Utility Banking are not misused for speculative purposes in property, stock markets, foreign currency transactions, and the complex web of margin deals and derivatives with which banks' whiz kids currently gamble depositors' and shareholders' hard-won resources.

The needs of investors who want adventure with appropriate risk are already catered for through the many Investment Funds which clearly grade the risk of their various investment vehicles. These Funds are subject to strict regulation, but regulation which simply ensures honesty and transparency in their specified dealings. This may, perhaps ungenerously be called Casino Banking. Investors enter with their eyes open, providing that funds are properly described, as indeed regulation should require. Gains and losses are confined to that sector alone, and do not spill over to affect banking and finance outside specific funds.

So we can conduct our day-to-day banking operations, and we can invest our savings in a Fund or mix of Funds which reflects individual appetite for risk.

The third type of banking, the least developed and yet the most important, is Development Banking, established regionally to ensure that the National Resource of *System-generated Credit* is used to maximize employment and productivity throughout the economy as a whole.

There is an ongoing need for investment in major infrastructure projects and environmental protection measures, as well as industrial development in backwater areas or areas experiencing major unemployment. However, there is no current mechanism for directing the flow of credit into economically depressed areas or regional infrastructure requirements. These investment demands are presently funded, either not at all, or by government as non-returnable grants out of taxes. This is an improper accounting practice which only serves to distort government accounts and increase government debt. In addition, when companies and projects in economically depressed areas receive outright grants rather than repayable loans, this distorts their own costings and may cause unfair competition. Grants lack the financial discipline which applies to loans which must

produce a repayment, and the use of taxpayers' funds for what should properly be investment only succeeds in further enlarging and obscuring government accounts.

Regional Development Banks, centrally coordinated and having access to a proportion of overall credit availability, making open decisions based on nationally and locally debated priorities, would deploy their credit allocation to make repayable loans for infrastructure and local development on a more businesslike footing, with the object of maximizing the overall nation's and each region's productive and employment potential.

The flow of credit created by the banking system is a national resource, not a resource of any specific bank or investment institution or individual saver. It is a resource having a substantial potential for the enhancement of prosperity, and it is moreover a scarce and finite resource. It is therefore entirely appropriate that this resource should be directed purposefully and publicly into projects which will improve employment, productivity and thus prosperity.

Full employment is one of the basic essentials of a civilized society, but it will not come about by chance. There is a tremendous potential for creativity in the world; most people want to do a useful job of work, and to do it well. Unemployment is not for most people a natural or preferred condition. System-generated Credit can be used to expand employment on a powerful scale, but only if it is guided by overall priorities.

Without selective criteria, the nation's System-generated Credit will not be used productively, and may well serve only to inflate property and stock market balloons which will eventually burst with the disastrous effects only too familiar in historical, recent, and indeed current banking experience.

If on the other hand System-generated Credit is recognized and accepted as a national resource, both valuable in its potential and limited in its quantity, Economic Policy can begin to exercise, first protective disciplines, then certain directional criteria so that credit can be channeled into infrastructure projects, areas of high unemployment, and productive investment at regional and local level.

Utility, Investment and Development: the Three Faces of Banking.

CREDIT MANAGEMENT

4. Development Banking

If *System-generated Credit* is clearly recognized as a national resource, and subject to proper disciplines, the banking system can deploy this resource so that it fulfils its potential function as a major contributor to growth, productivity and prosperity.

The commercial banks must deal with day-to-day matters such as current accounts, mortgages and loans for big-ticket consumer purchases, all of which are necessary functions. To take care of more specialized needs, Regional Development Banks should

be established with the specific purpose of investing in regional business and industry on an ongoing partnership basis, their decisions based on a rigorous assessment of project viability and guided by an overall regional investment strategy.

The cost of finance as charged by the Regional Development Banks would be limited to the Bank's administrative costs and the cost of loan insurance. There is of course an element of risk in any investment. The more useful approach however, is to minimize risk through proper pre-investment research and positive on-going monitoring of physical production, sales, and accounting – precisely the measures which a banking-industry partnership system is able to undertake.

A Standard Audit Format for accounting and quality/productivity performance would facilitate a follow-up monitoring process through which the investing banks are provided continuously with performance data from recipient companies, thus ensuring the safety both of the investment loan, and of the recipient company.

In the case of larger businesses, the investing bank may well appoint a Director to the Board, as already practiced in Germany. Careful monitoring will be to the advantage both of the investing bank and the recipient business, as well as to the regional economy: bankruptcy is not contributive to economic stability and prosperity.

The banking-industry partnership would therefore be in a position to offer investment at a relatively low cost, possibly 2-3%, backed by the on-going monitoring of the recipient business ensuring safeguards for the investing bank, the recipient business and all those involved with and dependent on it.

The highly successful Mondragon cooperative group in Basque Spain illustrates this ongoing relationship between investment banking and recipient business. The *Workers' Bank* serves three mutually inter-dependent functions: it provides investment as a local development bank, offers technical and financial advice for business startup, then monitors production, quality, and financial performance in a process of ongoing cooperation and partnership.

To fulfill these objectives, the Bank's operation is formally divided into two sectors. One deals with finance. The other comprises specialist departments, providing skilled commercial, architectural and technical advice either to assist existing enterprises or to promote new ones. Once launched, the new enterprise manages itself but the Bank guarantees continuing support in return for a flow of data from which the new enterprise's progress can be monitored – production, sales, profits and so on. If anything begins to go wrong, the Bank can give timely help, with advice or further finance if appropriate.

A similar and highly successful banking enterprise, the Grameen Bank, operates on a similar basis, directed more towards the needs of poorer developing countries.

The major distinguishing feature of this system is a relatively new concept of **forward-securitization**, in which *the total project, from design through production and*

management to sales, becomes the loan collateral, rather than the assets of the bank, or the personal assets of individuals. This is important. Comedian Bob Hope once remarked that “banks are institutions which lend money to people who can prove they don’t need it.” The availability of investment credit has enormous potential for growth, and the Development Banks should actively be seeking to maximize the productive use of this resource.

The partnership concept also assumes longterm commitment, resulting in the encouragement of secure long-range planning and productivity investment, as well as research and development into new-generation products and services in conjunction, perhaps, with more specialized venture capital funds.

The RDB could also provide investment finance for regional infrastructure, such loans to be repaid in the normal way by the relevant local or regional government departments from their own revenues.

Once proper disciplines and regulatory institutions are in place, creative use of the national credit base through System-generated Credit can act as a major source of economic motive power.

The Regional Development Banks would, like all areas of the banking sector, be strictly regulated to ensure the responsible use of created credit and investment funds, and would in addition be confined in their activities to their own specific region.

Within these qualifications they would be endowed with a substantial degree of autonomy in tailoring to regional needs both the quantity and the recipients of investment. They would also be able to set their own charges based on administrative costs and loan insurance.

Thus the RDB would prove a powerful catalyst at local level, providing finance and subsequent ongoing supervision for business and industrial development, together with investment capital for regional infrastructure.

A report commissioned by Britain’s Core Cities Group demonstrates that investment in local infrastructure repaid through an uplift in business taxes can create increases of between 50% and 80% in housing, jobs and economic output.

When the power of *System-generated Credit* is harnessed in order to bring out its full potential, any economy can be expanded to full employment. There are however problems in another area, namely the way we evaluate wages, prices, and indeed, our very currency unit.

STABILIZING VALUE

1. The Anatomy of Inflation

The ability to channel investment into areas of un- or under-employment offers the potential to expand the productive capacity of the economy to its maximum potential, that is to say, full employment.

Full employment has a number of advantages. A job is fundamental to life itself. Without a job little else can be achieved. Without a foot on the ladder, there is no hope of mounting. Unemployment also puts demands on those who do have jobs, since they must pay taxes to finance welfare benefits for the unemployed. At the national level, unemployment represents a waste of productive potential. It is an immediate waste in that 5% unemployment is a 5% reduction in potential production. And it discourages labour-shedding productivity improvements, since those with jobs are afraid of losing them.

When the London Underground system decided to replace ticket sellers and collectors with automated ticketing and barriers, Trades Unions opposed and blocked this labour-saving move for several years, fearing unemployment of their members. At the same time, the tramway administration in Zurich, Switzerland, decided to replace conductors with automatic ticket machines. The changeover took place smoothly as planned with no opposition. On the last day of conductor operation, there were tables set up outside the tram depot by firms seeking employees. Switzerland at that time enjoyed not only full employment, but a shortage of labour.

Some economists have suggested that a degree of unemployment is essential, since a tight labour market can hold back economic development; on the contrary, employers and managers at a Japanese labour conference in 1991, when the Japanese economy was still buoyant, were unanimous that the shortage of labour at that time had forced them into increased labour-saving productivity and automation.

A substantial degree of hardcore unemployment, on the other hand, causes employees to oppose labour-shedding productivity improvements for fear of losing their jobs and being unable to find alternative employment. This is much worse than it sounds. Prosperity is created and increased through advances in productivity, making better goods tomorrow with less labour than today. When workers in an economy oppose productivity, they are opposing prosperity.

Despite the clear disadvantages of unemployment, and the desirability of full productive use of all economic resources, the ability to expand an economy to full capacity cannot presently be realized, for as the economy expands to near-full employment, the danger of inflation causes the Central Bank to put the brakes on.

The problem is that our money has no defined value. Back in the simple craft market, all participants had a fair idea of what each product cost in terms of labour, skill and materials. But who today would know the constituent cost of a jacket or a kitchen mixer, a computer or high definition television set?

The result is that we're back to haggling, but on a national scale. We haggle over wages and prices. Money only has real meaning in terms of what you earn (wages), and what you can buy with what you earn (prices). But both wages and prices are open to continuing dispute and lack any form of definition or stability. None of our national currencies has any stable, clearly defined value, and all are subject to greed-motivated upward movement known as inflation. This in turn prevents economic expansion to full employment, sentencing the world's economies to the waste and human distress of substantial and permanent unemployment.

And the existence of inflation as a permanent feature of every world currency is a denial of one of the basic purposes of money known to every first-year economics student from the first day: money should act as a store of value. Yet a currency which loses – at the very best – 3% of its value every year is about as useful as a store of value, as a bucket with a hole in it could be used to store water.

Inflation is not the complex esoteric phenomenon economists would have us believe. It is simply a matter of human greed – our natural desire to get more reward for the same work. Inflation is an increase in price without a corresponding increase in value. If the price goes up for a better product that costs more to make, that is not inflation. But if a producer asks more tomorrow for the same product he sold for less yesterday, that is inflation.

Similarly with wages. More money for more or harder work is not inflation. Inflation is more money for doing exactly the same work.

In today's economies, the level of economic activity directly affects inflation.

When the economy is sluggish, producers and retailers find difficulty in moving their goods; they respond by introducing price reductions, incentives and special offers. But as the economy expands and consumer demand expands, prices can be increased without damaging sales.

Similarly with wages. Employees are naturally reluctant to demand more money, or threaten strike action, in a time of high unemployment with a lineup of job applicants outside the door. But when the economy approaches near-full employment and staff are hard to find, now's the time to demand that raise you've been wanting!

The price of goods and services on the market increases to match or exceed the value of credit available for their purchase. This is the dominant feature of a free market economy, and balancing the two highly desirable but conflicting goals of full employment and zero inflation or stable money is the key to national economic management today.

The economy is slack and inflation is low. So the Government and/or the Central Bank expands the economy by lowering interest rates. But when near-capacity is reached in the more prosperous regions, inflation begins to rise, and the Central Bank attempts to

control inflation by slowing down the economy with increased interest rates, thereby maintaining a level of permanent unemployment. Full employment and full productive use of resources in a free-market economy is an economic and financial impossibility. Thus getting a job becomes a game of musical chairs. For every hundred job-seekers, there are only at best ninety-five jobs. Similarly producers will be competing to sell their goods to a market which has insufficient credit to purchase them.

Recession or inflation? Our economic managers have two choices. Expand the economy to full employment and we get inflation. Or reduce inflation, by slowing down economic activity, creating unemployment and recession. The art of economic management as currently practiced lies in attempting to compromise between the two.

Apart from fiscal dishonesty and irresponsibility (printing money to gold-plate the presidential palace), inflation is not a monetary, but a social factor. In hard times people behave themselves. But when things get easier, producers put prices up for the same product or service, and employees demand more money for the same amount of work.

That is not an economic factor, explained with complex formulas and obscure economic jargon. It's simple human nature. Or to put it a little more plainly, it's simple human greed.

The underlying economic factor which makes this situation possible is that pay and prices are settled by a form of disputation. The price is as much as the producer can get, or as little as the consumer is willing to pay. Similarly, the wage is as much as the employee can get, or as little as the employer can get away with.

This process is commonly known as *free collective bargaining*. But it is inherently unstable and subject to continuous upward pressure fuelled by the simple human desire for more. While the desire for more wealth and prosperity both personally and nationally is a very reasonable one, an economy and its participants should seek to increase their personal and collective prosperity by becoming more productive, not by demanding more money for the same work or the same product.

The process of establishing pay, profits and prices by disputation results in friction, industrial disputes, loss of productivity, inflation, and permanent under-employment. It represents a facet of anarchy, in that it is a process of settling differences by unregulated dispute rather than by a system of debated and agreed guidelines and regulation.

STABILIZING VALUE

2. Full Employment without Inflation

Free Collective Bargaining on the wage, or pay side combined with totally unregulated market pricing is the key factor which prevents expansion to full employment. What, if any, are the alternative options?

A potential solution to this problem already exists, and needs only to be applied on a standardized national scale in order to bring stability – and justice, that essential precondition of stability – to the economy.

For many years, a number of government agencies and corporations large and small, have been using a system of *job evaluation* to evaluate the work each employee contributes. Each job is analyzed, and its essential characteristics and demands, such as training, responsibility, working conditions and physical/mental effort involved, are measured on a series of common scales. The job "value" is then directly related to remuneration. In this way, pay is fair, both in relation to the work done, and in relation to the pay and the work of others.

Currently there are several such systems in use, well tried and working successfully. It would not be difficult to analyze and compare their different features in order to establish a single standard. This would become in effect a national standard of value for measuring the work element contained in a product or service, so that pay becomes a true reflection of the work required of a job. Society already measures apples and gasoline; it could hardly get along otherwise. Yet of all the things traded every day, work is the most important, and work is the one commodity we do not measure.

A national standard would provide a point of reference, of justice indeed. Everyone would know how much they should get for the work they do, without hassle or argument or strike.

Labour evaluation can ensure remuneration stabilization. This process can be carried through to price stabilization.

A factory's, or a business's total costs consist of three elements. First, the cost of bought-in raw materials and components; second, the direct labour added in the factory; and third, the costs of capital write-off, overheads and finance.

These are the costs of making a product, of supplying a service. From these costs a Unit Production Cost can be calculated for each product or service supplied. If this Unit Production Cost then becomes the Selling Price, there would be a direct and fair relationship between cost and price, and therefore between pay and purchasing power.

But the Unit Production Cost is not normally equated with the Selling Price. The difference between the two is commonly referred to as the net profit. How is the net profit currently disposed of?

The prior destination for profits has traditionally been the investors, or shareholders. But today this is changing, reflecting in turn a new perception of the need to create a greater sense of teamwork.

Investment is vital, as also is the equipment it provides; but the machine is no longer the exclusive source of productivity and indeed its operation can be rendered useless without

the intelligent participation of the workforce. The reality today, becoming ever more widely recognized, is that the people who work in an enterprise are equally vital: their inventiveness, their enterprise and initiative, their attention to the job in hand, their commitment to quality, their extra thought and effort... these are the factors which if encouraged and harnessed can turn investment into productivity and prosperity, and which can turn a company's fortunes. Thus an annual workforce bonus reflecting performance of the company may also be included.

Apart from investor dividends and employee bonuses, the other major destination for the disposal of company profit is re-investment, either in research and equipment or increased working capital. The advantage is that in-house or self-generated investment comes without future servicing cost or commitment to repay.

There is one more claimant to a share in the profits, and that is the customer. Profits have to come from somewhere – or someone. In fact it is the customer who pays the price and generates the profit; with this view a further claim on profits would come from the consumer, demanding lower prices.

The stabilization of prices would require the establishment of public policy for profit distribution. This could take the practical form, first, of an overall profit ceiling.

Of the profit made, broad percentage bands could be established and gradually stabilized, distributing profit according to a pre-set formula as between co-workers at all levels, investors, and the internal needs of capital for reserves and re-investment.

As they do today, government revenue departments would continue to require that companies prepare in timely fashion properly audited annual accounts. Company profits would be examined in order to ensure that they are apportioned according to a consensus formula which respects the claims and contributions of consumers, investors, co-workers, and the future security of the business itself.

It should be noted that price stabilization effected in this way, through annual account regulation, would permit the same degree of latitude in pricing "deals" and special offers. But the profit ceiling would ensure an ultimate price stability.

Pay and price evaluation and stabilization would provide guidelines ensuring fair exchange between employer and employee, as well as between producer and consumer, without the need to argue or strike. More importantly, stable pay and prices would permit economic expansion to full employment without inflation.

Guidelines for remuneration/pay evaluation coupled with profit limitations would replace dispute with rules, and would move to stabilize pay and prices even in times of economic expansion. In such circumstances it would be possible to expand the economy steadily to full employment and hold it there indefinitely without fear of inflation. The results would be seen in full employment, monetary stability, and a high level of productive efficiency and thus prosperity.

“A fair day’s pay for a fair day’s work” – a fine-sounding slogan but hardly a reality today. The vast majority of working people slog away in factories and offices for the best part of their lives with nothing but a meager pension at the end of it – and even that may be in doubt. At the other end of the scale, the “fat cats” walk away with millions for having done little but presiding over a company’s decline. While this is causing growing, and justifiable resentment, the problem is very much deeper and more fundamental.

One major element of public contention during the crisis of 2008 was the fact that CEOs and executives who had presided over the near ruination of their banks and major finance houses were walking away with golden handshakes in the millions. Is that fair, people were asking? But how can one answer that, when we have no concept of relating pay to anything, and our monetary unit – if anyone bothers to think about it – has no concrete definition.

Our monetary unit has no basis, no defined value. Powered by the fundamental human desire for more, it tends to float gently upwards, and can be controlled only by recession and unemployment, which in turn creates opposition to productivity and thus to prosperity.

Many economists and observers have long been aware that money has no defined value. A response has been the suggestion of returning to commodity-based money, like gold or silver. But the limitations of such rigid restrictions have already been experienced. Credit needs to be available, and to expand, in direct relation to the economic activity it has to support, lubricate and finance.

In any case, precious metals themselves fluctuate in value, if for example a major new source of gold is discovered, its “value” relative to other commodities will necessarily fall.

But in the search for monetary stability and “something solid” on which to base it, we have constantly overlooked the most basic commodity of all: human labour. Everything comes back to labour. It’s the only thing we’re trading. The price of gold is ultimately defined in terms of labour: the amount of labour involved in exploration, location, mining and processing.

Labour is the one single commodity on which all else is based, in terms of which all else is measured and defined. It is the ultimate commodity on which to base our monetary unit.

Apart from irresponsible banking practices, many of our ongoing financial and economic troubles arise out of our monetary unit’s basic lack of definition. From this we get not just an underlying instability, but in practical terms, the need for a permanent degree of unemployment which in turn discourages productivity through fears of job losses. And it cannot be said often enough: prosperity is created through productivity, and opposition to productivity is opposition to prosperity itself.

Social Security in its widest possible sense is the goal of every well-governed society, and the only true "Social Security" is full employment, that utopian condition in which there is a rewarding job for everyone who wants one, with the guarantee of a fair day's pay for a fair day's work.

STABILIZING VALUE

3. Prosperity IS Productivity

Prosperity is created by production. We become prosperous, individually or collectively, by producing goods and services which people want and need, either for our own personal consumption, or for trade with others.

But production is only half the story. If we want to enhance and increase prosperity, production needs to be productive, it needs to be efficient. You can't increase your prosperity simply by working harder or longer. More hard work may increase your financial wealth, but at the expense of leisure, family time, and possibly also your health. To increase prosperity we need to work not harder but smarter, producing more and better goods tomorrow with less work than it took yesterday.

The old socialist economy in the Soviet Union offered guaranteed full employment, a job for everyone. But work was thoroughly unproductive. Some jobs were simply "make-work" employment, while in many factories, malfunctioning, out-dated equipment and shortage of parts often brought production to a prolonged standstill. Everybody working, yes. But also... everybody working productively.

Pay, Profit and Price Evaluation can permit economic expansion to full employment without inflation. And the productive, even aggressive use of System-Generated Credit can provide guided startup finance for new enterprises large and small, as well as credit for existing business seeking to update their equipment, expand, or generally raise productivity.

But there is also a social element involved in maximizing productivity.

First and foremost, the guarantee of "a rewarding job for everyone who wants one" and "a fair day's pay for a fair day's work" would go a long way towards ensuring a dispute-free industry and a more socially equitable society.

It must also be recognized and accepted that it is in the interests of everyone concerned in a business that it should be productive – and stay in business. And "everyone concerned" includes: owners, investors, and employees of course, but also suppliers and distributors, and the host community which is dependent on the company's wage-earners for secondary services. The problem is that these different interests may often see their own point of view to the exclusion of the whole. If business is to survive and prosper without

the waste and distress caused by failures and bankruptcies, then a holistic view of business in its totality must be maintained.

The consumer is the ultimate recipient of the product or service; indeed, since we produce solely in order to consume, the consumer must be the most important element in the process.

Good design, economical production, efficient and stable administration; all these factors have a direct bearing on the product or service as it is presented to the consumer.

And it is the consumer who suffers when a product fails to perform as it should, when its quality and service fall below the standard of which current technology is capable, or when it is over-priced as a result of wasteful production methods.

When products are poorly designed and inefficiently or wastefully manufactured, when services are careless and slipshod, when quality is poor, the consumer suffers.

But so also do the investors if the firm concerned fails to gain its potential market share. And employees suffer both from inefficient working conditions, and from the insecurity and potential job losses inevitably incurred in a poorly run company. The maintenance of high standards in any business is clearly in the interests of all its co-workers and investors, as well as the host community that depends on it for employment and prosperity.

In the wider context, businesses and industries are highly dependent on one another, for the supply of materials and components, for subcontracted work, for marketing and distribution. So the quality and reliability of one business affects, and is affected by that of several others.

This total integration and inter-dependence of co-workers at all levels and in all departments, together with investors, suppliers, distributors, host community and consumers, clearly reflects the reality that avoidable incompetence in any part of the chain affects others adversely if not disastrously.

Suppliers and distributors, as well as co-workers at all levels and in all departments should have the right to expect from one another the highest standards of professional conduct.

And consumers should have the right to expect that products and services reflect and embody the highest currently available techniques and capabilities in efficiency, quality and reliability.

Maintaining the highest possible standards in management, quality and productivity will maximize job satisfaction and job security for suppliers and co-workers, while consumers will enjoy the use of products and services which reflect a continuous improvement in quality at progressively falling prices.

Many of the industrial world's more forward-thinking executives have spoken out in favour of the need for a "stakeholder charter".

John Dasburg, retired CEO Northwest Airlines:

“My concern about the capitalist model is that while it seems to work and we're all involved in capitalism in an incredibly existential way, the fact of the matter is that there is, in my view, the need for some type of balance. Democracy didn't work without certain rights being guaranteed, what we call a Bill of Rights. And in my view there is somewhat of a bill of rights to capitalism. You just simply must take into consideration all of the various interests in society in the enterprise. And if you fail to do that, capitalism will fail. And we, as CEOs have a responsibility to see to it that we take into consideration all the stakeholders. And I just simply don't buy the view that maximizing shareholder value and disregarding other interests is a sensible way to run an organization. And certainly, in the long run, I think, it places in jeopardy the entire underlying economic system.”

A key factor in the consistently high productivity of Japanese industry is teamwork, the involvement of all employees in continuous quality and productivity improvement.

Another important factor ensuring high productivity is full employment. Experience in Japan, Switzerland and Germany has shown that full employment and a shortage of labour has forced companies to seek other ways of maintaining production, specifically through increased use of existing labour and a greater degree of automation. Another source of productivity has been the move to redesign products for ease of moulding and assembly – “click not screw”! Full employment encourages productivity, while the risk of losing jobs in conditions of high unemployment causes opposition to productivity-increasing job losses.

Prosperity, for a nation, its regions, and every person who is able and willing to work, will not come about when the potential of investment credit is misused or under-used, or when a section of the population is always unable to find employment.

The key to universal prosperity is simply stated:

everybody working,
everybody working productively.

But this principle is not confined to private sector industry and services. Far from it. Government expenditure in the developed economies claims anything between 40% and 50% of the nation's total wealth, so it is vital to maximize productivity in government. Regrettably this is rarely if ever considered as high priority in government circles – if indeed it is ever considered at all.

Private sector productivity is motivated not so much by a shining evangelism inspiring managements and workers to give their best to their customers, but rather it is goaded by the fear of being overtaken by the competition. Governments are spared the horrors of competition, and since their customers are compelled to use their services whether they

like it or not, it is hardly surprising that governments around the world are unproductive, extravagant and complacent.

The remedy lies in total openness of all government accounts down to the last detail, benchmark objectives for each department, and strict adherence to standard accounting practices including independent auditing. But no institution, least of all a monopoly government, can be expected to set disciplines upon itself. This is something which can only be set in place at constitutional level. If prosperity is to be maximized, government discipline and productivity is a key factor.

The longterm effect of productivity maximization combined with a labour-based monetary system is negative inflation. As productivity increases, the labour-content decreases, and it becomes possible for goods and services to be produced and offered at lower prices, thus progressively lowering the cost of living.

This has already happened in the field of computers and other electronics. Buy a computer today, and it is almost guaranteed that in three months' time the price will be lower for a faster machine with more storage space on its hard drive.

This in turn means that as we get older we can look forward to increased purchasing power for our savings. A wild dream? No. This is as it should be, the normal course of events. We should be increasing productivity, producing more and better at less cost. And with a stable monetary unit, increased productivity involving less labour is reflected in lower prices. Currently we are forced to rely on pension schemes defined in terms of inflating currency, and government schemes which are already heading for deep deficit. So we console ourselves with inflating home prices, ignoring the warnings that bust can follow boom.

Only with stable value, and the safe, productive, aggressive use of System-Generated Credit to ensure full employment and the maximization of productivity throughout the economy, will universal prosperity become a reality.

STABILIZING VALUE

4. Stabilizing Property Values

Late-night partying and the morning-after hangover. Have your fling then pay the price. It's a fairly familiar sequence of events. The home-mortgage and subsequent property crisis which contributed to a full-blown financial and stock-market disaster in 2008 followed much the same pattern, though many would not see it that way.

When house prices rise, there is general jubilation, especially among home-owners, many of whom will take out second mortgages, or additional commitments based on the increased "value" of their homes. That increased value however should not be confused

with real “added value” representing improvements made to the property which enhance its sale potential and its inherent value.

Every home, every commercial property has a “core value”, to a certain extent a notional value, yet still basically definable. The core value of a property begins with the cost of acquiring dead or agricultural land at non-inflated “development” prices, a share in the cost of providing services (water, gas, electricity, drainage etc), and the cost of building. This is the base price, the core value. Anything above that is hot air, froth on the coffee, not a real asset because while it is certainly capable of inflation, the inflation element over and above the core value is not real value, and it can disappear as fast as it grows.

Rapid increases in valuations of real estate property such as housing continue until they reach unsustainable levels relative to incomes and other economic elements. Then they crash – which in fact means that they return to a value more nearly reflecting the true or core value. The greater the inflation, the greater the fall. In the five years following Japan’s property-bust in 1990, commercial property prices had more than halved.

We must learn to look at house price inflation with suspicion, not jubilation.

The situation in the United States was further complicated by the mortgage structure. In the “good old days” you obtained a mortgage from your local Bank. If for any reason you could not manage your payments – temporary unemployment for example – the Bank having no wish to go into property management, would probably accommodate you. But not today. We’re far too sophisticated for that.

The financial wizards’ latest creation is ABCP which stands for Asset Backed Commercial Paper. Basically, banks and mortgage institutions sell their mortgage commitments to a Mortgage Fund which then sells shares in itself to investors and investment funds around the globe who may in turn sell shares in themselves to others. The idea is to spread risk. But instead it spread infection. For when the bubble burst it affected not a few identifiable mortgage lenders and banks, it spread throughout the world financial system. Just as homeowners did not know who held their mortgages, so complex investment funds holding funds-of-funds had no precise idea as to how great was their exposure to what became known as “toxic” mortgage paper.

This new miracle mortgage device effectively relieved the banks providing the mortgage of all responsibility, thus encouraging risky loans. The easy credit also widely available fuelled a boom both in housing prices and consumer spending.

It is widely recognized that better regulation is necessary, to ensure that mortgages are granted to those who can afford them, and are honestly described to the client.

An additional solution lies in the provision of an adequate stock of what is variously called “affordable”, “social” or in Britain “Council” housing. Subsidies should as far as possible be avoided, aiming rather for what can be called “at-cost” housing which reflects the “core value” defined above.

This can be achieved by using “grey” land, redundant industrial or government land, or marginal agricultural land purchased for housing at agricultural prices, then providing serviced homes at construction cost, the individual housing units, grouping and finishes designed to offer maximum quality and minimum cost. The aim should be the provision of quality housing in pleasant surroundings, as far as possible reflecting sustainable goals in recycling and integration with public transport services. Housing units could be wholly at-cost rental or leasehold accommodation or a mix of at-cost and market rates to ensure quality of upkeep. On-site management should ensure maintenance of high standards.

A substantial pool of quality at-cost housing reflecting a foundation of “real”, non-inflated prices as a base reference point would provide a much-needed facility of starter homes, and exercise a restraining influence on market-price housing thus reducing the upward pressure of inflation.

Rising land prices also have an environmental impact, tending to favour sprawl, as homes, shopping malls and businesses naturally seek to move out to areas of less value. Sprawl in turn generates more traffic because people have farther to travel; and it is essentially private vehicle traffic, since sprawl by its nature cannot economically or satisfactorily be served by shared public transport. Private vehicular traffic requires yet more road space, which quickly becomes clogged; speeds gradually decline, journey times get longer, and automobile pollution increases.

Yet more seriously, rising land prices are economically regressive, a fact which classical economists decline to recognize. Prosperity is created by productivity, by increasing value without increasing cost. Rising land prices do just the opposite: they increase the cost of land without increasing its inherent value. And this has a similarly inflationary effect on the services using land, which become more expensive not because they are offering increased value but simply because rents are going up. “Value” in the sense of what buyers get for their money, decreases as land prices increase. This is particularly evident in major cities.

There is little or nothing in the way of goods and services which is not affected by the price of land; rising real estate prices in towns and cities affect everything from offices to retail shops, cafés, and places of entertainment. The escalation of land prices is a major contributor to the high cost of urban living. It can also cause a deterioration in urban quality of life; many of Europe's old established city cafés which have for centuries been centres for meeting and socializing are now being forced to close as a direct result of escalating rents. Likewise the demise of urban centres in the USA came about when steadily increasing rents finally reached the point where businesses could no longer afford them and moved out instead to cheaper green field sites thus creating new suburbs.

If the city or town centre is to retain or regain and develop its function as a gathering place, it will be necessary to ensure that newly developed areas in city centres, particularly areas reclaimed from public or industrial use, should be subject to price stability so that rents are economic for those low-profit uses such as public markets and cafés which provide vitality and enjoyment for users.

This could be accomplished, for example, by vesting tenure in the hands of a locally administered Urban Trust, which would then ensure maintenance and management of the facility.

A central objective of good governance must be to ensure as far as possible a civilized life for all. And a key foundation element of a civilized life must surely include a quality, affordable home in pleasant surroundings within convenient reach of recreational opportunities and commercial facilities. If mortgage credit is properly and responsibly managed, home-buyers will not be encouraged to over-step the limits of their incomes. And a pool of at-cost affordable housing creates stability and a roof for young buyers until they can achieve a more secure financial situation.

Ultimately the prosperity of a nation and its citizens individually can best be guaranteed by full employment, fair remuneration, and increasing productivity in a stable economy. And this in turn requires that the nation's credit flow, its most vital resource, be protected from abuse and directed specifically towards releasing full productive potential.

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For further reading and links check

ProsperityEconomics.org

TheArtOfGoodGovernment.org

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Roads, bridges, piped water, electricity, telecommunications,
these and many more constitute vital elements of a nation's infrastructure.

But outweighing them all in importance is
a properly functioning monetary system.

We should get ourselves one.