

# Tearing apart the social fabric

Edward J Dodson on the stress fractures that are deepening in the US – and the role of banking

WE CAN thank Fred Harrison for a penetrating study of history, identifying an 18-year land market cycle going back hundreds of years. As we know, appreciation for the importance of this historical analysis is yet to become widespread. Only a small cadre of economists have ventured beyond the theoretical limits of neo-classical writings to explore the consequences of entrenched landed privilege which their predecessors analysed and debated during the era of the political economist. And, in recent years, a growing number of economic forecasters have abandoned *a priori* theoretical approaches in favor of a *posteriori* analysis of data and predictors of what is likely to happen in the future.

What we know and argue is that analysis that recognises the very real differences between *nature* and what we produce by applying our labour to nature has a distinct advantage when it comes to forecasting the future. To date, unfortunately, our collective efforts to establish such a forecasting capability have suffered from an absence of dedicated resources. Hopefully, a younger and more skeptical generation of economics professionals will find their way to a redirected theoretical vigour.

In the meantime, as we look at the global economy and the growing evidence that the system is highly stressed, our criticisms of conventional fiscal and monetary tools are affirmed. Nothing economists as public policy advisers have proposed has ever stabilised land prices. If anything, land speculation is as widespread today as ever. Population migrations, advances in technology transfer and global communications have stimulated urban land values all around the globe. The opportunities for rent-seeking gains, often making use of bank-provided credit, have simultaneously resulted in troubling patterns of increased wealth and income concentration in many of the social democracies: nowhere more so than in the United States.

Here in the us, serious cracks in the social

fabric have developed. None of the candidates hoping to win the us Presidency – with the possible exception of Dennis Kucinich – are even aware there is a problem with landed privilege. Democratic Party candidates talk about raising the tax rates on those with the highest incomes but make no distinctions between income that is earned or unearned (i.e. derived from producing goods rather than from rent-seeking privilege and subsidies). Nor do any of the candidates seem to be very worried by a us government debt that has passed \$9 trillion and is increasing by \$1.45 billion each day. George Bush's successor will be faced with the challenge of having to raise over \$500 billion each year just to service this debt. How seriously this debt level will stress credit markets and the global economy is uncertain. One thing is for sure, the pain will be felt by those least in a position to deal with greater hardship.

The signs of economic and societal stress in the us are apparent for all to observe. Some 44% of all us households have no financial reserves at all. A majority of households have no retirement plan except for that provided under the Social Security program. Nearly 33 million people live in households classified by the government as below the poverty level. One in four households who live in rented housing are required to devote over half of their monthly income just for rent; the cost of utilities – on a steady upward climb – is an added living expense.

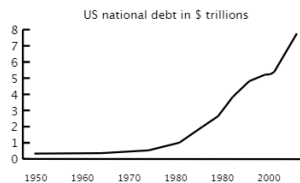
And, then there is our health care nightmare. The latest statistics indicate that just since 2002 the percentage of the

population covered by employment-based health insurance fell from 64.2% to 59.7%, while the number of uninsured in the us has climbed to 47 million. Obesity is a national epidemic, with nearly 25% of the population described as obese, including a steadily-increasing percentage of the nation's children and adolescents. The long-term implications of a population in such ill-health are frightening.

The us is also in the midst of what could easily devolve into another financial sector meltdown. Through the first half of 2007, nearly 461,000 bankruptcy petitions were filed in us federal court (5% of which involved businesses), resuming an upward trend in record filings which temporarily subsided in 2006, when total filings totaled *only* 590,000 – down from 2 million in 2005. (The most important reason for the significant drop in filings was passage in 2005 of the Bankruptcy Abuse Prevention Act, which made filing for bankruptcy a more involved and expensive process.)

Defaulting mortgage loans and the resulting home foreclosures are a major factor in the escalating number of individual bankruptcies. Foreclosure actions during the first half of 2007 have been pursued on over 573,000 properties (55% higher than in the first six months of 2006). This amounts to one foreclosure filing for every 134 households in the United States. In some parts of the us the number of foreclosures has been large enough to trigger even more defaults, as homeowners find themselves unable to carry the costs of rising interest rates on adjustable rate mortgages, yet unable to refinance into a fixed rate mortgage because of falling land values.

The stresses on the social fabric in the us are both serious and diverse. The tools employed by government are either ineffective or destructive. A real question is whether our circumstances will deteriorate at an accelerated pace, bringing on a full-blown depression; or, by some remarkable convergence of externalities the downturn will be moderate and relatively short-lived. **L&L**



JIM COCHRAN points us to a corner of the global economy not well-understood by most of its participants and a good many of its analysts. I am reminded of the book *Lost Prophets* by the former economics editor of the *Wall Street Journal*, Alfred Malabre, Jr. His assessment of the economists whose writings he scrutinised is worth repeating:

"Credentials seemed to matter little. Most economists, then as now, were degreed, typically sporting a doctorate as well as a master's degree in economics. But there was little relationship between the accuracy of individual forecasts and the academic backgrounds of particular forecasters. Few economists could match the credentials of Milton Friedman. Yet, his performance as a forecaster was abysmal"

There is one main reason why so few economists are able to accurately forecast changes in any economy. Neo-classical economic theory has evolved to describe almost everything as a form of capital. The environment is described as natural capital, just one more category of assets brought to the market by the price mechanism. Treating nature as capital may help to structure solvable equations but causes a serious misunderstanding of real world markets and forces.

Nature is more accurately described as the first factor of production, the factor with a zero cost in terms of labour and capital goods. Nature has been provided to us for our use and exploitation without charge by whatever forces created the universe. The supply curve for nature is vertical because locations on the earth are finite. Economists ignore the fact that as price increases there is a very strong tendency on the part of those who control locations on the earth to hoard them (and whatever resources are contained therein or thereon) in anticipation that curtailment of supply will drive up price (and profits) even higher. Monopolists have practiced this art of cornering control over the supply of essential natural resources for centuries, with governments often as their willing partners. Their strategy is to get in when the markets are just at the bottom, ride the markets to the point where they see widespread (and very irrational) exuberance, then get out before the inevitable crash. And, if they miscalculate,

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