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Source: *World Review of Political Economy* , Vol. 10, No. 2 (Summer 2019), pp. 171-190
Published by: Pluto Journals
Stable URL: https://www.jstor.org/stable/10.13169/worlrevipoliecon.10.2.0171

"CREATING WEALTH" THROUGH DEBT

The West's Finance-Capitalist Road

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Abstract: Volumes II and III of Marx's *Capital* describe how debt grows exponentially, burdening the economy with carrying charges. What policies are best suited for China to avoid this neo-*rentier* disease while raising living standards in a fair and efficient low-cost economy? The most pressing policy challenge is to keep down the cost of housing. Rising housing prices mean larger and larger debts extracting interest out of the economy. The strongest way to prevent this is to tax away the rise in land prices, collecting the rental value for the government instead of letting it be pledged to the banks as mortgage interest. The same logic applies to public collection of natural resource and monopoly rents. The US and European business schools are part of the problem, not part of the solution. They teach the tactics of asset stripping and how to replace industrial engineering with financial engineering, as if financialization creates wealth faster than the debt burden. Having rapidly pulled ahead over the past three decades, China must remain free of *rentier* ideology that imagines wealth to be created by debt-leveraged inflation of real-estate and financial asset prices.

Key words: Capitalism; financialization; debt; crisis; rentier

Western capitalism has not turned out the way that Marx expected. He was optimistic in forecasting that industrial capitalists would gain control of government to free economies from unnecessary costs of production in the form of rent and interest that increase the cost of living (and hence, the break-even wage level). Along with most other economists of his day, he expected *rentier* income and the ownership of land, natural resources and banking to be taken out of the hands of the hereditary aristocracies that had held them since Europe's feudal epoch. Socialism was seen as the logical extension of classical political economy, whose main policy was to abolish rent paid to landlords and interest paid to banks and bondholders.

A century ago there was an almost universal belief in mixed economies. Governments were expected to tax away land rent and natural resource rent, regulate monopolies to bring prices in line with actual cost value, and create basic infrastructure with money created by their own treasury or central bank. Socializing land rent was the core of physiocracy and the economics of Adam Smith. That was the path that European and American capitalism seemed to be following in the decades leading up to World War I. That logic sought to use the government to support industry instead of the landlord and financial classes.

China is progressing along this "mixed economy" road to socialism, but Western economies are suffering from a resurgence of the pre-capitalist *rentier* classes. Their slogan of "small government" means a shift in planning to finance, real estate and monopolies. This economic philosophy is reversing the logic of industrial capitalism, replacing public investment and subsidy with privatization and rent extraction. The Western economies' tax shift favoring finance and real estate is a case in point. It reverses Ricardian socialism based on public collection of the land's rental value and the "unearned increment" of rising land prices.

Defining economic rent as the unnecessary margin of prices over intrinsic cost value, classical economists through Marx described *rentiers* as being economically parasitic, not productive. *Rentiers* do not "earn" their land rent, interest or monopoly rent, because it has no basis in real cost-value (ultimately reducible to labor costs). The political, fiscal and regulatory reforms that followed from this value and rent theory were an important factor leading to Marx's value theory and historical materialism. The political thrust of this theory explains why it is no longer being taught.

By the late 19th century the *rentiers* fought back, sponsoring reaction against the socialist implications of classical value and rent theory. In America, John Bates Clark denied that economic rent was unearned. He redefined it as payment for the landlords' labor and enterprise, not as accruing "in their sleep," as J. S. Mill (1848, 630, book V, chapter II, section 5) had characterized it. Interest was depicted as payment for the "service" of lending productively, not as exploitation. Everyone's income and wealth was held to represent payment for their contribution to production. The thrust of this approach was epitomized by Milton Friedman's Chicago School claim that "there is no such thing as a free lunch"—in contrast to classical economics saying that feudalism's legacy of privatized land ownership, bank credit and monopolies was all about how to get a free lunch, by exploitation.

The other major reaction against classical and Marxist theory was English and Austrian "utility" theory. Focusing on consumer psychology instead of production costs, it claimed that there is no difference between value and price. A price is whatever consumers "choose" to pay for commodities, based on the "utility" that these provide—defined by circular reasoning as being equal to the price they pay. Producers are assumed to invest and produce goods to "satisfy consumer demand," as if consumers are the driving force of economies, not capitalists, property owners or financial managers.

Using junk-psychology, interest was portrayed as what bankers or bondholders "abstain" from consuming, lending their self-denial of spending to "impatient" consumers and "credit-worthy" entrepreneurs. This view opposed the idea of interest as a predatory charge levied by hereditary wealth and the privatized monopoly right to create bank credit. Marx quipped that in this view, the Rothschilds must be Europe's most self-depriving and abstaining family, not as suffering from wealth-addiction.

These theories that all income is earned and that consumers (the bourgeois term for wage-earners) instead of capitalists determine economic policy were a reaction against the classical value and rent theory that paved the way for Marx's analysis. After analyzing industrial business cycles in terms of under-consumption or over-production in volume I of *Capital*, volume III dealt with the pre-capitalist financial problem inherited from feudalism and the earlier "ancient" mode of production: the tendency of an economy's debts to grow by the "purely mathematical law" of compound interest.

Any rate of interest may be thought of as a doubling time. What doubles is not real growth, but the parasitic financial burden *on* this growth. The more the debt burden grows, the less income is left for spending on goods and services. More than any of his contemporaries, Marx emphasized the tendency for debt to grow exponentially, at compound interest, extracting more and more income from the economy at large as debts double and redouble, beyond the ability of debtors to pay. This slows investment in new means of production, because it shrinks domestic markets for output.

Marx explained that the credit system is external to the means of production. It existed in ancient times, feudal Europe, and has survived industrial capitalism to exist even in socialist economies. At issue in all these economic systems is how to prevent the growth of debt and its interest charge from shrinking economies. Marx believed that the natural thrust of industrial capitalism was to replace private banking and money creation with public money and credit. He distinguished interest-bearing debt under industrial capitalism as, for the first time, a means of financing capital investment. It thus was potentially productive by funding capital to produce a profit that was sufficient to pay off the debt.

Industrial banking was expected to finance industrial capital formation, as was occurring in Germany in Marx's day. Marx's examples of industrial balance sheets accordingly assumed debt. In contrast to Ricardo's analysis of capitalism's Armageddon resulting from rising land-rent, Marx expected capitalism to free itself from political dominance by the landlord class, as well as from the pre-capitalist legacy of usury.

This kind of classical free market viewed capitalism's historical role as being to free the economy from the overhead of unproductive "usury" debt, along with the problem of absentee landownership and private ownership of monopolies. Governments would make industries competitive by providing basic needs freely or at least at much lower public prices than privatized economies could match.

This reform program of industrial capitalism was beginning to occur in Germany and the United States, but Marx recognized that such evolution would not be smooth and automatic. Managing economies in the interest of the wage earners who formed the majority of the population would require revolution where reactionary interests fought to prevent society from going beyond the bourgeois socialism that stopped short of nationalizing the land, monopolies and banking.

World War I untracked even this path of "bourgeois socialism." *Rentier* forces fought to prevent reform, and banks focused on lending against collateral already in place, not on financing new means of production. The result of this return to pre-industrial bank credit is that most bank lending in the United States and Britain now takes the form of real estate mortgages. The effect is to turn the land's rental yield into interest.

That rent-into-interest transformation gives bankers a strong motive to oppose taxing land rent, knowing that they will end up with whatever the tax collector relinquishes. Most of the remaining bank lending is concentrated in loans for corporate takeovers, mergers and acquisitions, and consumer loans. Corporate capital investment in today's West is not financed by bank credit, but almost entirely out of retained corporate earnings, and secondarily out of stock issues.

The stock market itself has become extractive. Corporate earnings are used for stock buybacks and higher dividend payouts, not for new tangible investment. This financial strategy was made explicit by Harvard Business School Professor Michael Jensen (2003), who advocated that salaries and bonuses for corporate managers should be based on how much they can increase the price of their companies' stock, not on how much they increased production and/or business size. Corporate America's financial managers are turning financialized companies into debt-ridden corporate shells.

A major advantage of a government as chief banker and credit creator is that when debts come to outstrip the means to pay, the government can write down the debt. That is how China's banks have operated. It is a prerequisite for saving companies from bankruptcy and preventing their ownership from being transferred to foreigners, raiders or vultures.

Classical tax and banking policies were expected to streamline industrial economies, lowering their cost structures as governments replaced landlords as owner of the land and natural resources (as in China today) and creating their own money and credit. But despite Marx's understanding that this would have been the most logical way for industrial capitalism to evolve, finance capitalism has failed to fund capital formation. Finance capitalism has hijacked industrial capitalism, and neoliberalism is its anti-classical ideology.

The result of today's alliance of the finance, insurance and real estate (FIRE) sector with natural resource and infrastructure monopolies has been to reverse that the 20th century's reforms promoting progressive taxation of wealth and income. Industrial capitalism in the West has been detoured along the road to rent-extracting privatization, austerity and debt serfdom.

The result is a double-crisis: austerity stemming from debt deflation, while public health, communications, information technology, transportation and other basic infrastructure are privatized by corporate monopolies that raise prices charged to labor and industry. The debt crisis spans government debt (state and local as well as national), corporate debt, real estate mortgage debt and personal debt, causing austerity that shrinks the "real" economy as its assets and income are stripped away to service the exponentially growing debt overhead. The economy polarizes as income and wealth ownership are shifted to the neo-*rentier* alliance headed by the financial sector.

This veritable counter-revolution has inverted the classical concept of free markets. Instead of advocating a public role to lower the cost structure of business and labor, the neoliberal ideal excludes public infrastructure and government ownership of natural monopolies, not to speak of industrial production. Led by bank lobbyists, neoliberalism even opposes public regulation of finance and monopolies to keep their prices in line with socially necessary cost of production.

To defend this economic counter-revolution, the national income and product accounts (NIPA) and gross domestic product (GDP) measures now used throughout the world were inspired by opposition to progressive taxation and public ownership of land and banks. These statistical measures depict finance, insurance and real estate as the leaders of wealth creation, not the creators merely of debt and *rentier* overhead.

What Is China's "Real" GDP and "Real Wealth Creation"?

Rejection of classical value theory's focus on economic rent—the excess of market price over intrinsic labor cost—underlies the post-classical concept of GDP.

Classical rent theory warned against the FIRE sector siphoning off nominal growth in wealth and income. The economics of Adam Smith, David Ricardo, J. S. Mill and Marx share in common the view that this *rentier* revenue should be treated as an overhead charge and, as such, *subtracted* from national income and product because it is not production-related. Being extraneous to the production process, this *rentier* overhead is responsible for today's debt deflation and economically extractive privatization that is imposing austerity and shrinking markets from North America to Europe.

The West's debt crisis is aggravated by privatizing monopolies (on credit) that historically have belonged to the public sector. Instead of recognizing the virtues of a mixed economy, Frederick Hayek and his followers from Ayn Rand to Margaret Thatcher, Ronald Reagan, the Chicago School and libertarian Republicans have claimed that *any* public ownership or regulation is, *ipso facto*, a step toward totalitarian politics.

Following this ideology, Alan Greenspan aborted economic regulation and decriminalized financial fraud. He believed that in principle, the massive bank fraud, junk-mortgage lending and corporate raiding that led up to the 2008 crisis was more efficient than regulating such activities or prosecuting fraudsters.

This is the neoliberal ideology taught in US and European business schools. It assumes that whatever increases financial wealth most quickly is the most efficient for society as a whole. It also assumes that bankers will find honest dealing to be more in their economic self-interest than fraud, because customers would shun fraudulent bankers. But along with the mathematics of compound interest, the inherent dynamic of finance capitalism is to establish a monopoly and capture government regulatory agencies, the justice system, central bank and Treasury to prevent any alternative policy and the prosecution of fraud.

The aim is to get rich by purely financial means—by increasing stock-market prices, not by tangible capital formation. That is the opposite of the industrial logic of expanding the economy and its markets. Instead of creating a more productive economy and raising living standards, finance capitalism is imposing austerity by diverting wage income and also corporate income to pay rising debt service, health insurance and payments to privatized monopolies. Progressive income and wealth taxation has been reversed, siphoning off wages to subsidize privatization by the *rentier* class.

This combination of debt overgrowth and regressive fiscal policy has produced two results. First, combining debt deflation with fiscal deflation leaves only about a third of wage income available to be spent on the products of labor. Paying interest, rents and taxes—and monopoly prices—shrinks the domestic market for goods and services.

Second, adding debt service, monopoly prices and a tax shift to the cost of living and doing business renders neo-*rentier* economies high-cost. That is why the US economy has been deindustrialized and its Midwest turned into a rust belt.

How Marx's Economic Schema Explains the West's Neo-*rentier* Problem

In volume I of *Capital*, Marx (1906) described the dynamics and "law of motion" of industrial capitalism and its periodic crises. The basic internal contradiction that capitalism has to solve is the inability of wage earners to be paid enough to buy the commodities they produce. This has been called overproduction or underconsumption, but Marx believed that the problem was in principle only temporary, not permanent.

Volumes II and III of Marx's *Capital* (1909a, 1909b) described a pre-capitalist form of crisis, independent of the industrial economy: Debt grows exponentially, burdening the economy and finally bringing its expansion to an end with a financial crash. That descend into bankruptcy, foreclosure and the transfer of property from debtors to creditors is the dynamic of Western finance capitalism. Subjecting economies to austerity, economic shrinkage, emigration, shorter life spans and hence depopulation, it is at the root of the 2008 debt legacy and the fate of the Baltic states, Ireland, Greece and the rest of southern Europe, as it was earlier the financial dynamic of Third World countries in the 1960s through 1990s under International Monetary Fund (IMF) austerity programs. When public policy is turned over to creditors, they use their power for asset stripping, insisting that all debts must be paid without regard for how this destroys the economy at large.

In his draft notes on "Interest-Bearing Capital and Commercial Capital in Relation to Industrial Capital"[1] for what became volume III of *Capital* (Marx 1909b) and part III of *Theories of Surplus Value* (1971), Marx wrote optimistically about how industrial capitalism would modernize banking and financial systems. Its historical task, he believed, was to rescue society from usurious money lending and asset stripping, replacing the age-old parasitic tendencies of banking by steering credit to finance productive investment.

> The commercial and interest-bearing forms of capital are older than industrial capital, but . . . [i]n the course of its evolution, industrial capital must therefore subjugate these forms and transform them into derived or special functions of itself. It encounters these older forms in the epoch of its formation and development. It encounters them as antecedents . . . not as forms of its own life-process. . . . Where capitalist production has developed all its manifold forms and

> has become the dominant mode of production, interest-bearing capital is dominated by industrial capital, and commercial capital becomes merely a form of industrial capital, derived from the circulation process. (Marx 1971, 468)

From antiquity through medieval times, investment was self-financed—and hence was undertaken mainly by large public institutions (temples and palaces) and by the well-to-do. It was the great achievement of industrial capitalism to mobilize credit to finance production, subordinating hitherto usurious interest-bearing capital to "the conditions and requirements of the capitalist mode of production" (Marx 1909b, 710).[2] "What distinguishes the interest-bearing capital, so far as it is an essential element of the capitalist mode of production, from usurer's capital," Marx wrote, is "the altered conditions under which it operates, and consequently the totally changed character of the borrower" (1909b, 705).

Marx expected the industrial revolution's upsweep to be strong enough to replace this system with one of productive credit, yet he certainly had no blind spot for financial parasitism.[3] Money-lending long preceded industrial capital and was external to it, he explained, existing in a symbiosis much like that between a parasite and its host. "Both usury and commerce exploit the various modes of production," he wrote. "They do not create it, but attack it from the outside" (Marx 1909b, 716). In contrast to industrial capital (tangible means of production), bank loans, stocks and bonds are legal claims on wealth. These financial claims do not create the surplus directly, but are like sponges absorbing the income and property of debtors—and expropriate this property when debtors (including governments) cannot pay. "Usury centralises money wealth," Marx elaborated.

> It does not alter the mode of production, but attaches itself to it as a parasite and makes it miserable. It sucks its blood, kills its nerve, and compels reproduction to proceed under even more disheartening conditions . . . usurer's capital does not confront the laborer as industrial capital. . . . (Marx 1909b, 699)

But it "impoverishes this mode of production, paralyzes the productive forces instead of developing them" (Marx 1909b, 699).

Engels noted that Marx would have emphasized how finance remained largely predatory had he lived to see France's Second Empire and its "world-redeeming credit-phantasies" explode in "a swindle of a magnitude never witnessed before" (Marx 1909b, 711, footnote 116). But more than any other writer of his century, Marx described how periodic financial crises were caused by the tendency of debts to grow exponentially, without regard for growth in productive powers. His notes provide a compendium of writers who explained how impossible it was in practice to realize the purely mathematical "magic of compound interest"—interest-bearing debts in the form of bonds, mortgages and commercial paper growing independently of the economy's ability to pay.[4]

This self-expanding growth of financial claims, Marx wrote, consists of "imaginary" and "fictitious" capital inasmuch as it cannot be realized over time. When fictitious financial gains are obliged to confront the impossibility of paying off the exponential growth in debt claims—that is, when scheduled debt service exceeds the ability to pay—breaks in the chain of payments cause crises. "The greater portion of the banking capital is, therefore, purely fictitious, and consists of certificates of indebtedness (bills of exchange), government securities (which represent spent capital), and stocks (claims on future yields of production)" (Marx 1909b, 552). A point arrives at which bankers and investors recognize that no society's productive powers can long support the growth of interest-bearing debt at compound rates. Seeing that the pretense must end, they call in their loans and foreclose on the property of debtors, forcing the sale of property under crisis conditions as the financial system collapses in a convulsion of bankruptcy. To illustrate the inexorable force of usury capital unchecked, Marx poked fun at Richard Price's calculations about the magical power of compound interest, noting that a penny saved at the birth of Jesus at 5% would have amounted by Price's day to a solid sphere of gold extending from the sun out to the planet Jupiter (Marx 1973, 842; 1909b, 463, chapter 29).

> The good Price was simply dazzled by the enormous quantities resulting from geometrical progression of numbers. . . . He regards capital as a self-acting thing, without any regard to the conditions of reproduction of labor, as a mere self-increasing number. (Marx 1909b, 699)

It is subject to the growth formula Surplus = Capital $(1 + \text{interest rate})^n$, with n representing the number of years money is left to accrue interest. The exponential all-devouring usury "assimilates all the surplus value with the exception of the share claimed by the state" (Marx 1909b, 699). That at least was the hope of the financial class: to capitalize the entire surplus into debt service.

> Under the form of interest the whole of the surplus over the necessary means of subsistence (the amount of what becomes wages later on) of the producers may here be devoured by usury (this assumes later the form of profit and ground rent). (Marx 1909b, 699)

Although high finance obviously has been shaped by the Industrial Revolution's legacy of corporate finance, institutional investment such as pension fund saving as part of the industrial wage contract, mutual funds, and globalization along "financialized" lines, financial managers have taken over industrial companies to create what Hyman Minsky has called "money manager capitalism":

> Capitalism in the United States is now in a new stage, money manager capitalism, in which the proximate owners of a vast proportion of financial instruments are mutual and pension funds. The total return on the portfolio is the only criteria used for judging the performance of the managers of these funds, which translates into an emphasis upon the bottom line in the management of business organizations. (Cited in Wray 2009)

The last few decades have seen the banking and financial sector evolve beyond what Marx or any other 19th-century writer imagined. Corporate raiding, financial fraud, credit default swaps and other derivatives have led to de-industrialization and enormous taxpayer bailouts. And in the political sphere, finance has become the great defender of deregulating monopolies and "freeing" land rent and asset-price gains from taxation, translating its economic power and campaign contributions into the political power to capture control of public financial regulation. The question that needs to be raised today is therefore which dynamic will emerge dominant: that of industrial capital as Marx expected, or finance capital?

Fictitious Capital

Bankers and other creditors produce interest-bearing debt. That is their commodity as it "appear[s] in the eyes of the banker," Marx wrote. Little labor is involved. Calling money lent out at interest an "imaginary" or "void form of capital" (Marx 1909b, 461), Marx characterized high finance as based on "fictitious" claims for payment in the first place because it consists not of the means of production, but of bonds, mortgages, bank loans and other claims on the means of production. Instead of consisting of the tangible means of production on the asset side of the balance sheet, financial securities and bank loans are claims on output, appearing on the liabilities side. So instead of creating value, bank credit absorbs value produced outside of the rentier FIRE sector. "The capital of the national debt appears as a minus, and interest-bearing capital generally is the mother of all crazy forms. . . ." (1909b, 547) What is "insane," he explained, is that "instead of explaining the self-expansion of capital out of labor-power, the matter is reversed and the productivity of labor-power itself is this mystic thing, interest-bearing capital" (1909b, 548).

Financialized wealth represents the capitalization of income flows. If a borrower earns 50 pounds sterling a year, and the interest rate is 5%, this earning power is deemed to be "worth" *Y*/*I*, that is, income (*Y*) discounted at the going rate of interest (*I*): 1000 pounds. A lower interest rate will increase the capitalization rate—the amount of debt that a given flow of income can carry. The forming of a fictitious capital is called capitalizing. Every periodically repeated income is capitalized by calculating it on the average rate of interest, as an income which would be realized by a capital at this rate of interest.

Thus, Marx concluded:

> If the rate of interest falls [from 5] to 2.5%, the same securities will represent a capital of £200. Their value is always merely capitalized income, that is, the income calculated on the basis of a fictitious capital at the prevailing rate of interest. (Marx 1909b, 551, chapter 29)

Finance capital is fictitious in the second place because its demands for payment cannot be met as economy-wide savings and debts mount up exponentially.

The magic of compound interest diverts income away from being spent on goods or services, capital equipment or taxes. Marx wrote:

> In all countries of capitalist production, there exists in this form an enormous quantity of so-called interest-bearing capital, or moneyed capital. And by accumulation of money-capital nothing more, in the main, is connoted than an accumulation of these claims on production, an accumulation of the market-price, the illusory capital-value of these claims. (Marx 1909b, 551, chapter 29)

Banks and investors hold these "certificates of indebtedness (bills of exchange), government securities (which represent spent capital), and stocks (claims on future yields of production)" whose face value is "purely fictitious" (Marx 1909b, 551, chapter 29).[5] This means that the interest payments that savers hope to receive cannot be paid in practice, because they are based on fiction—junk economics and junk accounting, which are the logical complements to fictitious capital.

Finance capital sees any flow of revenue as economic prey—industrial profit, tax revenue, and disposable personal income over and above basic needs. The result is not unlike the "primitive accumulation" by armed conquest—land rent paid initially to warrior aristocracies. And much as the tribute taken by the military victors is limited only by the defeated population's ability to produce an economic surplus, so the accrual of interest on savings and bank loans is constrained only by the ability of borrowers to pay the mounting interest charges on these debts. The problem is that the financial system, like military victors from Assyria and Rome in antiquity down to those of today, destroys the host economy's ability to pay.

Finance Capital's Raid on Industry

Having analyzed finance capital's tendency to grow exponentially, Marx did not incorporate this idea into his long-term system. Having provided a compendium of historical citations recognizing the self-expanding character of money-capital multiplying at compound interest, he announced that finance capital would be subordinated to the dynamics of industrial capital rather than growing to dominate it. "In the course of its evolution, industrial capital must therefore subjugate these forms and transform them into derived or special functions of itself" (Marx 1971, 468). With an optimistically Darwinian and indeed Victorian ring he wrote that the destiny of industrial capitalism was to mobilize finance capital to fund its economic expansion, rendering usury an obsolete vestige of the "ancient" mode of production. "Where capitalist production has developed all its manifold forms and has become the dominant mode of production," Marx concluded his draft notes for *Theories of Surplus Value*, "interest-bearing capital is dominated by industrial capital, and commercial capital becomes merely a form of industrial capital, derived from the circulation process" (Marx 1971, 468). The financial problem would take care of itself as industrial capitalism mobilized savings more productively than ever before had been the case.

Marx defined "primitive accumulation" as the seizure of land and other communally held assets by raiders and the subsequent extraction of tribute or rent. Today's financial analogue occurs when banks create credit freely and supply it to corporate raiders for leveraged buyouts or to buy the public domain being privatized. Just as the motto of real estate investors is "rent is for paying interest," that of corporate raiders is "profit is for paying interest." Takeover specialists and their investment bankers pore over balance sheets to find undervalued real estate and other assets, and to see how much cash flow is being invested in long-term research and development, depreciation and modernization that can be diverted to pay out as tax-deductible interest.

Whatever is paid out as income taxes and dividends likewise can be turned into tax-deductible interest payments. The plan is to capitalize the target's cash flow—calculated as earnings before interest, taxes, depreciation and amortization (EBITDA)—into payments to the bankers and bondholders who advance the credit to buy out existing shareholders (or government agencies). For industrial firms such leveraged buyouts (LBOs) are called "taking a company private," because its stock ownership is no longer publicly available.

Permitting interest to absorb the revenue hitherto paid out as taxes and (after-tax) dividends to stockholders is diametrically opposite to replacing debt with equity funding as Saint-Simon and subsequent reformers hoped to bring about. The logical end—and the dream of bank marketing departments—is for all cash flow (earnings before interest, taxes, depreciation and amortization) to be paid out as interest, leaving nothing over for taxes, capital renewal and modernization to raise labor productivity and living standards. All land rent, corporate profit, tax revenue and personal income over and basic spending is to be pledged to banks and bondholders as interest.

Under such conditions fortunes are made most readily not by industrial capital formation but by indebting industry, real estate, labor and governments, siphoning off the economic surplus in interest, other financial fees, bonuses, and "capital" gains. Populations willingly go into debt as it appears that gains can be made most easily by buying real estate and other assets on credit—as long as asset prices rise at a pace higher than the rate of interest.

Today's financial investors aim at "total returns," defined as earnings plus capital gains—with increasing emphasis on the latter gains in real estate, stocks and bonds. Industrial companies increasingly are "financialized" to produce such gains for investors, not to increase tangible capital formation. The "bubble" or Ponzi phase of the financial cycle aims to create the financial equivalent of a perpetual motion machine, sustaining an exponential debt growth by creating enough new credit to inflate real estate, stock and bond prices at a rate that (at least for a while) enables debtors to cover the interest falling due. As a recent popular phrase puts it, financial collapse is staved off by the indebted economy trying to "borrow its way out of debt."

This asset-stripping dynamic, which Marx characterized as usury capital, is antithetical to that of industrial capital. Based on the liabilities side of the balance sheet, financial securities take the form of anti-wealth—legalized claims on the means of production and income earned productively. The underlying dynamic is fictitious, because it cannot remain viable for long. It sustains interest payments by stripping assets, leaving the economy with less ability to produce a surplus out of which to pay creditors. And indeed, the financial sector destroys life on a scale similar to military conquest. Birth rates fall, life spans shorten and emigration soars as economies polarize.

This is the "free market" alternative to the Progressive Era and socialist reforms. It typifies the IMF austerity plans that epitomize centralized planning on behalf of the global financial sector. Yet pro-financial ideologues depict public ownership, regulation and taxation as the road to serfdom, as if the alternative endorsed by Frederick Hayek, Ayn Rand and Alan Greenspan were not a road to debt peonage. And the endgame of this dynamic is a financial crash, wiping out savings that have been lent out beyond the indebted economy's ability to pay.

It is at this point that the financial sector wields its political power to demand public bailouts in a vain attempt to preserve the financial system's ability to keep on expanding at compound interest. Much as environmental polluters seek to shift the cleanup costs onto the public sector, so the financial sector demands cleanup of its debt pollution at taxpayer expense. The fact that this is now being done in the context of ostensibly democratic politics throws a leading assumption of political economy into doubt. If economies tend naturally to act in their self-interest, how did the financial sector gain such extractive power to raid and dismantle industry and shed its tax burden?

If Darwinian models of self-betterment are to explain the past century's development, they must show how creditors have translated their financial power into political power in the face of democratic Parliamentary and Congressional reform. How has planning become centralized in the hands of Wall Street and its global counterparts, not in the hands of government and industry as imagined almost universally a century ago? And why has social democratic, labor and academic criticism become so silent in the face of this economic counter-enlightenment?

The Political Problem of Finance Capital and "Fictitious Capital" in General

Western economies stand at a critical turning point. What blocks them from freeing themselves from their debt overhead is a political problem: the credit that has bid up asset prices was created largely on the base of wealth owned by the richest 1%—and they have gained control of ostensibly democratic governments. Between 1979 and 2004, the 1% raised their share of the returns to wealth in the United States—interest, dividends, rents and capital gains—from 38% of the national total to 58% (Congressional Budget Office of US Government 2014). Little of this wealth was created industrially by building factories to employ labor to produce goods and services to sell at a markup. Investors sought "total returns" mainly in the form of capital gains, not current income. The government encourages this by taxing capital gains at only a fraction of the rate levied on wages and profits. So the vast overgrowth of financial overhead is largely autonomous from "real" economic growth. The result is that much as environmental pollution causes global warming, new credit has been extended to bid up real estate and other asset prices, "heating up" the bubble economy.

For Marxists there is a certain irony in this. The financial crisis that plagues today's world does not stem primarily from the "real" economy. Little of the credit that has bid up prices for real estate, stocks and bonds came from savings generated from productive investment employing or exploiting labor (except to loot its pension funds). It was created largely electronically, on computer keyboards. The banking system has been decoupled from the real economy. The financial sector's independent and self-referential expansion path is independent of the "real" economy's surplus, or its ability to support this overhead. Financial returns are made in extractive ways, as a subtrahend from the surplus created by labor and tangible capital, rather than funding capital accumulation. Productivity is raised by working labor harder and exploiting it more, not by technology.

Only at the end of an epoch can its dynamics be seen for what they are and where they have been leading. Most people only want to think about a financial crash after it has happened. Only then does a pressing reason arise to realize that the economy does not need to be structured in this way, and that the time has come to contemplate alternatives.

Western economies have tax laws that encourage debt leveraging by permitting interest on takeover loans and related speculation to be tax deductible. The stock market has become a vehicle for replacing equity with debt. This is the opposite trend from what Saint-Simon and subsequent 19th-century theorists of industrial banking sought to promote. Money is made not by what Marx described as making money (*M*) to hire labor to produce commodities (*C*) to sell at a markup (*M′*), but by avoiding the production process altogether by *M–M′*, making money "work."

But money doesn't work in the sense that labor or tangible capital expends effort to produce commodities. Credit is debt, and debt extracts interest. Financial salesmen who promise investors, "Make your money work for you," actually mean that society should work for the creditors—and that means working for the banks that create credit.

The effect is to turn the economic surplus into a flow of interest payments, diverting revenue from tangible capital investment. As the economy's reproductive powers are dried up, the financialization process is kept going by easing credit terms and lending—not to produce more goods and services, but to bid up prices for the real estate, stocks and bonds being pledged as collateral for larger and larger loans.

The success of China as compared to non-Marxist economies lies precisely in its avoidance of letting the economy be run to benefit the financial sector. Its strategy has been based so far on using finance to serve its industrial and overall economic development. To keep finance and banking in their proper place remains a major political task of China, in the face of Western pressure from neoliberal strategists seeking to persuade China to financialize its economy.

China has managed to avoid this dynamic. But to the extent that it sends its students to study in US and European business schools, they are taught the tactics of asset stripping instead of capital formation—how to be extractive, not productive. They are taught that privatization is more desirable than public ownership, and that financialization creates wealth faster than it creates a debt burden. The product of such education therefore is not knowledge but ignorance and a distortion of good policy analysis. Baltic austerity is applauded as the "Baltic Miracle," not as demographic collapse and economic shrinkage.

The experience of post-Soviet economies when neoliberals were given a free hand after 1991 provides an object lesson. Much the same fate has befallen Greece, along with the rising indebtedness of other economies to foreign bondholders and to their own *rentier* class operating out of capital-flight centers. Economies are obliged to suspend democratic government policy in favor of emergency creditor control.

The slow economic crash and debt deflation of these economies is depicted as a result of "market choice." It turns out to be a "choice" for economic stagnation. All this is rationalized by the economic theory taught in Western economics departments and business schools. Such education is an indoctrination in stupidity.

Most private fortunes in the West have stemmed from housing and other real estate financed by debt. Until the 2008 crisis the magnitude of this property wealth was expanded largely by asset-price inflation, aggravated by the reluctance of governments to do what Adams Smith, John Stuart Mill, Alfred Marshall and nearly all 19th-century classical economists recommended: to keep land rent out of private hands, and to make the rise in land's rental value serve as the tax base.

Failure to tax the land leaves its rental value "free" to be pledged as interest to banks—which make larger and larger loans by lending against rising debt ratios. This "easy credit" raises the price of obtaining home ownership. Sellers celebrate the result as "wealth creation," and the mainstream media depict the middle class as growing richer by higher prices for the homes its members have bought. But the debt-financed rise in housing prices ultimately creates wealth mainly for banks and their bondholders.

Americans now have to pay up to 43% of their income for mortgage debt service, federally guaranteed.[6] This imposes such high costs for home ownership that it is pricing the products of US labor out of world markets. The pretense is that using bank credit (that is, homebuyers' mortgage debt) to inflate the price of housing makes US workers and the middle class prosperous by enabling them to sell their homes to a new generation of buyers at higher and higher prices each generation. This certainly does not make the buyers more prosperous. It diverts their income away from buying the products of labor to pay interest to banks for housing prices inflated on bank credit.

Consumer spending throughout most of the world aims above all at achieving status. In the West this status rests largely on one's home and neighborhood, its schools, transportation and other public investment. Land-price gains resulting from public investment in transportation, parks and schools, other urban amenities and infrastructure, and from re-zoning land use. In the West this rising rental value is turned into a cost, falling on homebuyers, who must borrow more from the banks. The result is that public spending ultimately enriches the banks—at the tax collector's expense.

Debt is the great threat to modern China's development. Burdening economies with a *rentier* overhead imposes the quasi-feudal charges from which classical 19th-century economists hoped to free industrial capitalism. The best protection against this *rentier* burden is simple: first, tax away the land's rising rental valuation to prevent it from being paid out for bank loans; and second, keep control of banks in public hands. Credit is necessary, but should be directed productively, and debts written down when paying them threaten to create financial Armageddon.

Marx's Views on the Broad Dynamics of Economic History

Plato and Aristotle described a grand pattern of history.[7] In their minds, this pattern was eternally recurrent. Looking over three centuries of Greek experience, Aristotle found a perpetual triangular sequence of democracy turning into oligarchy, whose members made themselves into a hereditary aristocracy—and then some families sought to take the *demos* into their own camp by sponsoring democracy, which in turn led to wealthy families replacing it with an oligarchy, and so on.

The medieval Islamic philosopher Ibn Khaldun[8] saw history as a rise and fall. Societies rose to prosperity and power when leaders mobilized the ethic of mutual aid to gain broad support as a communal spirit raised all members. But prosperity tended to breed selfishness, especially in ruling dynasties, which Ibn Khaldun thought had a life cycle of only about 120 years. By the 19th century, Scottish Enlightenment philosophers elaborated this rise-and-fall theory, applying it to regimes whose success bred arrogance and oligarchy.

Marx saw the long sweep of history as following a steady upward secular trend, from the ancient slavery-and-usury mode of production through feudalism to industrial capitalism. And not only Marx but nearly all 19th-century classical economists assumed that socialism in one form or another would be the stage following industrial capitalism in this upward technological and economic trajectory.

Instead, Western industrial capitalism turned into finance capitalism. In Aristotelian terms the shift was from proto-democracy to oligarchy. Instead of freeing industrial capitalism from landlords, natural resource owners and monopolists, Western banks and bondholders joined forces with them, seeing them as major customers for as much interest-bearing credit as would absorb the economic rent that governments would refrain from taxing. Their success has enabled banks and bondholders to replace landlords as the major *rentier* class. Antithetical to socialism, this retrogression towards feudal *rentier* privilege let real estate, financial interests and monopolists exploit the economy by creating an expanding debt wedge.

Marx's (1956, 1968, 1971) *Theories of Surplus Value* (German *Mehrwert*), his history of classical political economy, poked fun at David Ricardo's warning of economic Armageddon if economies let landlords siphon off of all industrial profits to pay land rent. Profits and hence capital investment would grind to a halt. But as matters have turned out, Ricardo's *rentier* Armageddon is being created by his own banking class. Corporate profits are being devoured by interest payments for corporate takeover debts and related financial charges to reward bondholders and raiders, and by financial engineering using stock buybacks and higher dividend payouts to create "capital" gains at the expense of tangible capital formation. Profits also are reduced by firms having to pay higher wages to cover the cost of debt-financed housing, education and other basic expenses for workers.

This financial dynamic has hijacked industrial capitalism. It is leading economies to polarize and ultimately collapse under the weight of their debt burden. That is the inherent dynamic of finance capitalism. The debt overhead leads to a financial crisis that becomes an opportunity to impose emergency rule to replace democratic lawmaking. So contrary to Hayek's (1944) anti-government "free enterprise" warnings, "slippery slope" to totalitarianism is not by socialist reforms limiting the *rentier* class's extraction of economic rent and interest, but just the opposite: the *failure* of society to check the *rentier* extraction of income vesting a hereditary autocracy whose financial and rent-seeking business plan impoverishes the economy at large.

Greece's debt crisis has all but abolished its democracy as foreign creditors have taken control, superseding the authority of elected officials. From New York City's bankruptcy to Puerto Rico's insolvency and Third World debtors subjected to IMF "austerity programs," national bankruptcies shift control to centralized financial planners in what Naomi Klein (2008) has called disaster capitalism. Planning ends up centralized not in the hands of elected government but in financial centers, which become the *de facto* government.

England and America set their economic path on this road under Margaret Thatcher and Ronald Reagan by 1980. They were followed by even more pro-financial privatization leaders in Tony Blair's New Labour Party and Bill Clinton's New Democrats seeking to roll back a century of classical reforms and policies that gradually were moving capitalism toward socialism. Instead, these countries are suffering a rollback to neo-feudalism, whose neo-*rentier* economic and political ideology has become mainstream throughout the West. Despite seeing that this policy has led to North America and Europe losing their former economic lead, the financial power elite is simply taking its money and running.

So we are brought back to the question of what this means for China's educational policy and also how it depicts economic statistics to distinguish between wealth and overhead. The great advantage of such a distinction is to help steer economic growth along productive lines favoring tangible capital formation instead of policies to get rich by taking on more and more debt and by prying property away from the public domain.

If China's main social objective is to increase real output to raise living standards for its population—while minimizing unproductive overhead and economic inequality—then it is time to consider developing its own accounting format to trace its progress (or shortcomings) along these lines. Measuring how its income and wealth are being obtained would track how the economy is moving closer toward what Marx called socialism.

Of special importance, such an accounting format would revive Marx's classical distinction between earned and unearned income. Its statistics would show how much of the rise in wealth (and expenditure) in China—or any other nation—is a result of new tangible capital formation as compared to higher rents, lending and interest, or the stock market.

These statistics would isolate income and fortunes obtained by zero-sum transfer payments such as the rising rental value of land sites, natural resources and basic infrastructure monopolies. National accounts also would trace overhead charges for interest and related financial charges, as well as the economy's evolving credit and debt structure. That would enable China to measure the economic effects of the banking privileges and other property rights given to some people.

That is not the aim of Western national income statistics. In fact, applying the accounting structure described above would track how Western economies are polarizing as a result of their higher economic rent and interest payments crowding out spending on actual goods and services. This kind of contrast would help explain global trends in pricing and competitiveness. Distinguishing the FIRE sector from the rest of the economy would enable China to compare its economic cost trends and overhead relative to those of other nations. I believe that these statistics would show that its progress toward socialism also will explain the remarkable economic advantage it has obtained. If China does indeed make this change, it will help people both in and out of China see even more clearly what its government is doing on behalf of the majority of its people. This may help other governments—including my own—learn from its example and praise it instead of fearing it.

Notes

1. See https://www.marxists.org/archive/marx/works/1863/theories-surplus-value/add3.htm.
2. All subsequent quotations from *Capital* are from this edition.
3. See, for instance, "[i]n place of the old exploiters, whose exploitation was more or less patriarchal because it was largely a means of political power, steps a hard money-mad parvenu" (Marx 1909b, 700).
4. It is only in the English-language translations of Marx's *Theories of Surplus Value* III (Marx 1971, 296, 527–537).
5. The term fictitious capital passed into general circulation. In the United States, it meant capitalized unearned income ("economic rent," income without cost-value, mainly in the forms of ground rent

and monopoly rent as well as financial extraction of revenue). Henry George (1891) picked it up in *The Condition of Labor*, referring to the "fictitious capital that is really capitalized monopoly."

6. See http://www.homebuyinginstitute.com/news/fha-debt-to-income-296.
7. See http://www.isnature.org/Files/Aristotle.
8. See http://muslimheritage.com/article/ibn-khaldun-his-life-and-works.

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