Working Paper No. 708

The Road to Debt Deflation, Debt Peonage, and Neofeudalism

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February 2012

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ISSN 1547-366X

ABSTRACT

What is called “capitalism” is best understood as a series of stages. Industrial capitalism has given way to finance capitalism, which has passed through pension fund capitalism since the 1950s and a US-centered monetary imperialism since 1971, when the fiat dollar (created mainly to finance US global military spending) became the world’s monetary base. Fiat dollar credit made possible the bubble economy after 1980, and its substage of casino capitalism. These economically radioactive decay stages resolved into debt deflation after 2008, and are now settling into a leaden debt peonage and the austerity of neo-serfdom.

The end product of today’s Western capitalism is a neo-*rentier* economy—precisely what industrial capitalism and classical economists set out to replace during the Progressive Era from the late 19th to early 20th century. A financial class has usurped the role that landlords used to play—a class living off special privilege. Most economic rent is now paid out as interest. This rake-off interrupts the circular flow between production and consumption, causing economic shrinkage—a dynamic that is the opposite of industrial capitalism’s original impulse. The “miracle of compound interest,” reinforced now by fiat credit creation, is cannibalizing industrial capital as well as the returns to labor.

The political thrust of industrial capitalism was toward democratic parliamentary reform to break the stranglehold of landlords on national tax systems. But today’s finance capital is inherently oligarchic. It seeks to capture the government—first and foremost the treasury, central bank, and courts—to enrich (indeed, to bail out) and untax the banking and financial sector and its major clients: real estate and monopolies. This is why financial “technocrats” (proxies and factotums for high finance) were imposed in Greece, and why Germany opposed a public referendum on the European Central Bank’s austerity program.

Keywords: Debt Deflation; Neofeudalism; Economic Rent; Finance Capitalism; Classical Political Economy; Pension Fund Capitalism; Bubble Economy

JEL Classifications: B12, N23

"THE FUTURE OF CAPITALISM"—WHAT KIND OF CAPITALISM DO WE MEAN?

What is so striking in the recent debates about the future of capitalism is confusion about just what *kind* of capitalism is being talked about. Most people have in mind industrial capitalism's tangible investment in plant and equipment, employing labor to produce output at a markup (profit). But the Western world is now on a path of economic austerity, shrinking employment and downsizing. Corporations are using their cash flow and borrowing mainly for stock buybacks, debt-leveraged privatization of public assets, and buyouts of assets already in place. Banks are lending mainly to other financial institutions, not to investors or consumers, and most credit growth is for speculating in foreign exchange and interest rate arbitrage.

This is not what was envisioned when the Industrial Revolution was peaking in the 19th and early 20th century. To expand markets and increase their economies' competitive pricing position, classical economists sought to free their societies from the legacies of feudalism—a landed aristocracy extracting land rent, and a banking class extracting interest and converting national debts into the creation of monopoly trading privileges. Progressive Era reformers accordingly defined a free market as one with a government strong enough to tax away land rent and either break up monopolies or keep them in the public domain. The aim was to bring market prices in line with minimum necessary cost-value. This required a strong enough government to tax and check the vested financial, insurance, and real estate (FIRE) interests.

When Joseph Schumpeter spoke about creative destruction, he was referring to innovations that raised productivity, enabling new companies to unseat the old by lowering costs below those of competitors. The main change that he envisioned was new industrial companies emerging on the wave of innovations. Lower costs were supposed to be passed onto consumers in the form of falling prices. The resulting expansion of production would raise wage levels in keeping with productivity, as production required a parallel growth in consumer demand.

Companies were not supposed to be destroyed and left as bankrupt shells by financial raiders. Banking was expected to be modernized to promote industrial capital investment, not loot it by loading it down with interest charges and financial fees by raiders wielding junk bonds as their weapon of choice. To supporters and strategists of industrial capitalism, the driving dynamic was what the Wharton Business School professor Simon Patten called the "Economy of Abundance." Innovations in modes of financial takeovers of industry were more in the character of parasitic destruction—and few observers anticipated just how creative this destructive appropriation could become. Or that it would achieve ultimate victory by attacking and taking over government agencies, the central bank, and Treasury.

Despite the steady rise in productivity, prices have not fallen and real wages have not increased for the past generation (since the late 1970s in the United States). Economic gains have been enjoyed by the FIRE sector, dominated mainly by high finance. Industrial capitalism has evolved into finance capitalism in ways not dreamed of a century ago. And finance capitalism itself turns out to be an evolutionary family of offshoots: pension fund capitalism, the bubble economy, debt deflation, austerity—and the way today's trends seem to be leading, perhaps settling into a terminal stage of debt peonage and neofeudalism.

What already is clear is that instead of the promised economy of abundance, economic policy from the United States to Europe and the post-Soviet countries is now all about austerity. In a bubble economy, most gains are made not by industrial investment, but by borrowing to buy assets whose price is being inflated by bank credit. The shift of focus from industrial profits to debt-leveraged "capital" gains took the form mainly of land-price gains and higher capitalization multiples for stocks and bonds reflecting falling interest rates. Real estate spurted for a while, but price rises reversed after September 2008, leaving a trail of negative equity (when debts exceed asset valuations). This has dragged down balance sheets for the banks and insurance companies whose loans and default guarantees went bad.

Foreclosure time has arrived, reducing debt-strapped populations, "financialized" industrial companies, cities, states, and entire national governments from Ireland to Greece to debt peonage. Even the banking sector finds itself in negative equity. Companies and localities are claiming that they face bankruptcy if they cannot roll back pensions and even current wage levels and health care commitments. This is what debt deflation looks like.

Instead of suffering a merely temporary deviation from an underlying positive growth trend—a "cyclical downturn" resulting from "illiquidity"—Western economies have entered a fatal phase change. Debt service exceeds the economic surplus, leading to shrinkage. The problem is insolvency—an overgrowth of debt, growing autonomously by its own dynamics ("the miracle of compound interest" plus the banks' electronic creation of new credit). Belief that "automatic stabilizers" will correct the problem is a cover story for deterring public policies to rein in the banks from their over-lending and speculation.

The solution must come from outside the industrial economy by a debt write-down. This is how economies normally restored balance and renewed growth from before 2500 BC to 500 BC, by royal Clean Slates. It is how Solon acted to ban debt bondage in Athens, paving the way for the democratic take-off, and how Sparta's kings Agis and Cleomenes later sought to reverse the financial polarization between creditors and debtors. In Judaism, the Jubilee Year was what Jesus announced that he had come to proclaim. In more modern times, Germany's Economic Miracle was triggered by the 1947 Allied monetary reform and debt cancellation.

The great economic fiction of our time is that all debts can be paid—if only countries submit to enough austerity, impoverish their labor force, close down enough industry, and let banks foreclose on enough factories—and while they are at it, cut back social security, health care, and social spending across the board. This is class warfare waged by finance against the rest of the economy. It is even stifling the industrial economy, "post-industrializing" it in the West by destroying domestic consumer markets for output that employees produce.

It is ironic that the left wing of today's political spectrum—socialist, Social Democratic and Labour parties—tends to support the financial sector and its policy of "advance foreclosure" on public debtors (euphemized as "privatization"). One Marxist tradition blames the financial crisis almost entirely on the internal dynamics of industrial capitalism—the fight between labor and its employers over wages and benefits. In this view, capitalists accumulate industrial profits by not paying labor enough to buy the products it creates. The industrial sector behaves in a self-destructive way as employers seek their own immediate gains, not that of the economy at large. Rising wages are a precondition for raising labor productivity (and hence, for cutting costs), and poorly paid labor lacks the purchasing power to buy what it produces. Other critics of industrial capitalism blame the economic crisis on high technology causing unemployment—and off-shoring production to low-wage countries.

FINANCE CAPITALISM VS. INDUSTRIAL CAPITALISM AND THEIR RESPECTIVE MODES OF EXPLOITATION

These are indeed eternal problems between employers and employees. But today's labor is exploited increasingly in a financial way. Corporate raiders empty out their pension funds (or at least, downsize pension payouts by threatening bankruptcy) and seize Employee Stock-Ownership Plans (ESOPs), while bankers charge labor directly by personal loans, mortgage loans, and student loans. The FIRE sector has shifted the tax burden off itself onto consumers and financialized saving in advance for Social Security to produce a fiscal surplus that is used to cut taxes on the wealthy. The corporate sector and the economy at large have been "financialized," their surplus consumed in the form of debt service rather than invested in new capital formation to employ labor and produce more to raise living standards.

What is important to realize is that most debt in today's economies is taken on to buy real estate (housing and office buildings) and financial securities. Within the industrial sector, most corporate debt taken on for leveraged buyouts, or for "poison pills" as companies defend themselves against such financial aggression. To focus on the dynamics of industrial capitalism rather than those of finance capitalism leaves out of account the fact that banks make loans and create debt (and deposits) on their computer keyboards. An autonomous financial dynamic is at work, not merely savings by the industrial sector to be mediated by bankers.

Marx described the industrialists' hatred of landlords and the wish from Ricardo through Henry George to create an industrial circular flow by minimizing land rent. The buildup of property claims and savings (owed by the economy's renters and debtors) in the hands of *rentiers* is the result of industrial capitalism's *failure* to complete its political destiny: freeing economies from postfeudal *rentiers*. Today's financial power to set tax policy, make and enforce the law, and disable public regulation reflects the weakness of industrial capitalism in the face of the vested interests that have fought back against the Progressive reform movement since the 1870s.

Industrial capitalism's familiar class conflict between employers and wage labor is now being overwhelmed by financial dynamics. It is appropriate to speak of debt pollution of the economic environment, turning the economic surplus into debt service for leveraged buyouts, real estate rents into mortgage interest, personal income into debt service and late fees, corporate cash flow into payments to hedge funds and corporate raiders, and the tax surplus into financial bailouts as banks themselves succumb to the economy's plunge into over-indebtedness and negative equity.

The buildup of *rentier* wealth derives less from manufacturing than from real estate and monopolies, and most of all from finance. These *rentier* drives by the Finance, Insurance and Real Estate (FIRE) sectors are largely responsible for post-industrializing the economy. But that does not mean that matters can be reversed by "manufacturing more once again." The industrial past cannot be recovered without winding down the debt overhead, topped by debt-leveraged prices for housing and commercial real estate, health care, education and pensions. Yet instead of confronting the financial problem, US and European leaders blame China. They attribute its success entirely to manufacturing, not to the mixed public/private economy that has avoided privatization along financialized lines.

Misinterpretation of the West's financial problem and its corollary untaxing of finance, insurance and real estate—and of China's success in avoiding this takeover—reflects the success of *rentiers* in rejecting classical political economy's doctrine of value and price, and its corollary distinction between earned and unearned income, and productive and unproductive labor. These concepts are no longer taught. Censorial neoliberal ideology has succeeded in expunging the history of economic thought from the curriculum and popular discussion.

This self-promotion by *rentiers* has gouged out a blind spot that is crippling economic policy today. Forecasting by correlation analysis and regression equations and kindred statistical model building assumes the status quo as far as the "environment" of institutional and tax structures is concerned. As "wealth creation" becomes an increasingly fictitious Enron-style "mark-to-model" accounting, academic economics likewise becomes more an exercise in science fiction depicting a kind of parallel universe. There is method behind its madness. The streamlining of economic theory along the lines of junk statistics has turned the discipline into bland public relations for the financial sector.

Classical economics was the political program of industrial capitalism seeking to free society from the *rentier* interests. Resisting the classical distinctions between productive and unproductive investment, credit and employment, the postclassical economists endorsed by the *rentiers* (receiving their charitable largesse as well as the "badge of true science") insist that all income and wealth is earned productively. Everyone earns whatever he or she makes, so there is no unearned wealth. There are no "idle rich."

This is the political service performed by the postclassical Austrian and "neoclassical" counter-revolution: denial that *rentiers* play an unnecessary role. The implication is that Balzac was simply writing fiction when he quipped (following Proudhon's "Property is theft") that the great family fortunes are grounded in long-forgotten and suppressed thefts of the public domain and by financial and political insider dealing. One indeed finds more description of how great fortunes are made from novelists than from economists. When it comes to wealth and the power elite, today's economic models barely scratch the surface.

Today's austerity is being imposed to squeeze out more debt service. This requires either the suspension of democratic government in debt-strapped countries, as in Greece (where Angela Merkel dissuaded the Prime Minister Papandreou from submitting the European Central Bank's austerity plan to a voter referendum), or political distractions to convince voters to elect neoliberal parties on a platform of ethnic nationalism or other noneconomic issues, as in Latvia and its Baltic neighbors. As economic growth gives way to shrinkage (except for public and private debt overhead and the concentration of property ownership), what seemed to be the long-term trend of parliamentary reform over the past two centuries is being reversed.

Turning economic theory into a logic justifying *rentier* wealth distracts attention from the widening rake-off of economic rent and financial extraction. The assumptions made by neoliberal orthodoxy deny in principle that what is happening can really be occurring at all! The hope is that people look at the map, not at the territory. It is a false map, turning academic economics into science fiction about a happy parallel universe where everyone is fairly rewarded and the world becomes more equal and prosperous. In the real world, "balance sheet wealth" has become financialized. This means debt-leveraged—and increasingly post-industrialized. Under industrial capitalism, profits were made by investing in plant and equipment to employ labor to sell goods (and a widening array of services) at a markup. Most profits were to be reinvested in this way, including research and development. And today, retained earnings continue to be the main source of tangible capital investment—not bank lending, the stock market, or other external financing.

Two surgeons, Dr. William Petty in Ireland and Dr. Francois Quesnay in France, used the analogy of the circular flow of blood in the human body for how national income is circulated between producers and consumers, employers and employees (known popularly as Say's Law), and between the government and the private sector.

The Great Depression saw this circular flow interrupted. The siphoning off had been occurring ever since feudal times by *rentiers* extracting access charges for basic needs. Keynes blamed the depression on saving and hoarding out of the circular flow. But the problem today is the diversion of consumer income (wages), corporate cash flow, and public tax revenues to pay interest and amortization. This leaves less available for spending on goods and services.

The banks and other financial institutions and creditors receiving this debt service do not use it to finance tangible investment. They lend out their revenue to become additional debt claims on the bottom 99 percent of families, and on corporate industry and governments.

To minimize this diversion of revenue, industrial capitalism had to confront the vested interests entrenched from feudal Europe's epoch of military conquest: a landed aristocracy and banking families. Paying rent and interest for access to land and credit diverted the circulation of income between production and consumption. Malthus argued that landlords spent their rent on coachmen, tailors, and servants. But most classical economists deemed such spending unproductive because it did not employ wage labor to produce goods to sell at a profit.

As real estate has become democratized, buyers can obtain housing and commercial property by borrowing mortgage credit. The winning buyer is whoever outbids others to pledge the most rent to the bank as interest in exchange for a loan. The purchase price usually ends up with the entire rent being pledged—and sometimes the anticipated capital gain as well. *This makes banks the recipients of the groundrent that was paid to landlords prior to the 20th century*.

Banks also pressed governments to create commercial privileges and other monopolies. They traded in government bonds for the infrastructure and trading rights being sold off. To the extent that these public enterprises were bought largely on credit, their extraction of monopoly rent, like land rent, ends up being paid out as interest as these rights are traded and sold.

The symbiosis between banking and government was the agreement that government bonds would be the foundation of most bank reserves. Most of this public debt originated as war debt, because wars traditionally are the major cause of budget deficits. Adam Smith urged nations to finance wars on a pay-as-you-go basis so that populations would feel the immediate expense and make an informed choice for peace instead of burdening economies with war debts owed to financiers. The way to bring prices in line with the technologically necessary costs of production—and hence to win export markets—was thus to replace war with peace. Minimizing or taxing away land rent, monopoly rent and financial charges became the dream of classical economics as a political reform program.

PENSION FUND FINANCE CAPITALISM

Finance capitalism took a great leap forward in the 1950s with the innovation of pension fund capitalism, which Peter Drucker went so far as to applaud as "pension fund socialism." The idea was to set aside part of the wage bill for professional money managers on Wall Street to invest in the stock and bond markets. General Motors and other companies described this as giving labor a stake in industrial capitalism, by turning them capitalist in miniature.

Equities are indeed ownership shares. But they do not give labor much voice in management, even for workplace conditions or other employment practices. The situation is similar to that which prompted minority New York Yankees baseball investor John McMullen to complain: "There is nothing in life quite so limited as being a limited partner of [managing partner] George Steinbrenner." If managers lay off workers or use cash flow for stock buybacks or higher dividend payouts rather than for new direct investment and hiring, labor is supposed to see itself benefiting as a financial investor.

Pensions could have been organized in a variety of ways. Public pensions could have been paid out of the general budget's progressive income taxation, as in Germany's pay-as-you-go system. At the other end of the spectrum, Employee Stock Ownership Plans (ESOPs) gave workers stock in their employers. These plans ran the danger of being wiped out in bankruptcy or mergers. This ploy was refined most notoriously in Chile after 1973 under General Pinochet. Recently at the Chicago Tribune, real estate magnate Sam Zell used the company's ESOP to pay off his creditors, leaving a bankrupt shell and an impending set of lawsuits.

None of the above plans gave workers managerial positions on the corporate boards, as in Germany. Instead of being spent on the consumer goods that labor was producing, payments to pension funds were spent on stocks and bonds. What Pinochet (to be echoed by his admirer Margaret Thatcher in Britain) would call "labor capitalism" was more accurately "labor finance capitalism." Pension contributions were invested in financial markets, pushing up asset prices. The valuation of wealth rose—real estate, stocks and bonds—relative to labor's wages and salaries.

This proved a boon for managers and venture capitalists exercising their stock options. These insiders sold, and pension funds bought. The rising inflow of funding inspired dreams that pensions could be paid out of capital gains rising exponentially. By the time the dot.com bubble got underway in the 1990s, a rate of 8 percent compounded annually was almost universally projected. Any given amount would double every nine years and quadruple in eighteen to pay much larger future pensions. Soon, the only way to keep pension plans solvent at given "defined contribution" rates was for their investments to keep on expanding at this unsustainably high rate.

The only way to achieve this return even for a short while was for the Federal Reserve to flood the economy with credit—that is, with debt. So pension fund finance capitalism became dependent on the bubble economy orchestrated by Federal Reserve Chairman Alan Greenspan and continued by his successor, Ben Bernanke, to lower interest rates steadily down through 2012, capitalizing corporate profits and real estate rents into bank loans at rising multiples.

According to the rosy textbook pictures, the stock market is supposed to raise funding for industry. But stock ownership itself was being decoupled from management, just as the financial sector was becoming independent of tangible capital formation. As pension funds became part of the financial sector, they played a major role in the leveraged buyouts that loaded down companies with junk-bond debt. Confronted by Michael Milken at Drexel Burnham cheerleading from the 1980s onward, healthy companies were obliged to defend themselves by taking "poison pills," going so deeply into debt so that raiders could not take on any more to buy them. Some companies used their cash flow and even borrowed to buy up their stock so as to raise its price by enough to leave less revenue available for prospective raiders to pay their bankers and bondholders.

FIAT MONEY BASED ON AMERICA'S MILITARIZED BALANCE-OF-PAYMENTS DEFICIT

To understand what made the bubble economy's credit wave possible, it is necessary to understand how the international financial system was transformed in 1971 when overseas military spending forced the US dollar off gold. The metal was a pure asset, earned by running balance-of payments surpluses—and sold off by running trade and payments deficits. President Nixon's suspension of gold sales through the London Gold Pool left the world's central banks without a means of settling their balance-of-payments deficits (James Steuart called gold "the money of the world" in 1767), except to use what had become a proxy for gold: US Treasury bonds.

These government IOUs were supplied by the US economy running a balance-of-payments deficit. Ever since the Korean War broke out in 1950, this deficit stemmed entirely from military spending. US trade and private-sector investment were in balance, and what was called "foreign aid" actually generated a payments inflow (being tied to the purchase of US exports). So the dollars that ended up as global central bank reserves were the embodiment of America's military spending. (I describe its dynamics in my 1972 book, *Super Imperialism*.)

Removal of gold as an international constraint meant that the larger the US payments deficit grows, the more dollars end up in the hands of foreign central banks—which have had little alternative but to recycle them to the US economy by buying Treasury bonds. *The balance-of-payments deficit thus has become the means of financing the government's domestic budget deficit*.

The link between the dollarized global monetary system and military force became explicit after the Organization of the Petroleum Exporting Countries (OPEC) quadrupled its oil prices in 1973-74 in response to the US quadrupling of grain prices. Treasury officials met with Saudi Arabian and other OPEC officials and explained that they could charge as much as they wished for oil (which provided a price umbrella for US oil companies to make windfall "resource rent" profits), as long as they agreed to hold their reserves in US Treasury bonds or otherwise recycle their export earnings into the US economy—by buying stocks, real estate and other property claims, but not ownership of strategic industries.

US economic strategists soon came to realize that American investors could buy up foreign assets without limit, while consumers also imported more. Running up foreign debt created a proportional inflow of funds to buy Treasury bonds. This reversed the traditional impact of trade and payments deficits on interest rates. Under the gold standard, countries running deficits had to raise interest rates to borrow enough to stabilize their currencies' exchange rates. But for the US economy, the larger the payments deficit, the more foreign capital was recycled *into* US financial markets. Banks were able to create their own credit electronically without international constraint.

For the past thousand years the major factor in balance-of-payments deficits has been military. This often has led to a loss of economic sovereignty. But under the Treasury-bill standard the US economy achieved a free lunch. Under the new monetary imperialism, foreign central banks absorbed the cost of US military spending—and in due course the US private-sector takeover of their economies.

Monetarily, the US payments deficit had become inflationary, not deflationary as was the rule for all countries in times past. However, the inflation was contained entirely within the US financial and real estate markets. Labor and consumers were not the beneficiaries.

THE BUBBLE ECONOMY

By 2002, a full-blown financial and real estate bubble was underway. For the first time in history, people imagined that the way to get rich was by running into debt, not by staying out of it. As the Federal Reserve pushed interest rates down, prices for real estate, bonds and stocks rose—being worth whatever a bank would lend.

The problem for pension funds was that the falling interest rates that fueled the bubble's rising "capitalization rates" of income into bank loans meant lower current returns. This made it more expensive to buy a retirement income. By 2011, California's giant pension plan, CalPERS, was making only a 1.1 percent return. Yet as noted above, nearly all pension funds since the 1980s have made their projected ability to pay retirees on the assumption that they can make at least an 8 percent rate of total returns (interest plus dividends) year after year. By the time interest rates hit their bottom (1 percent), there was no more source of capital gains from higher bank liquidity lowering them further.

Pension funds tried to catch up by speculating in financial derivatives that had no counterpart in tangible investment or employment. To make matters worse, financial fraud was effectively decriminalized as the Justice Department, Securities and Exchange Commission, and other regulatory agencies refused to prosecute. Fraud became part of the "free market." Regulatory agencies were understaffed, and administrators were chosen who were committed to not enforcing the rules. Many appointees reaped their rewards for inaction by what the Japanese called "descent from heaven." They received enormously well paying jobs when they left these agencies to join the sectors they had been charged with regulating. Politicians made eloquent calls for new laws—while refraining from using those already on the books that had long been used.

Banks and pension funds lent mainly to other financial institutions, not to finance new capital formation or employment. *The new era of asset-price inflation had changed the* *economic aim—in fact, the foundation of economic solvency—to making capital gains by debt leveraging*. By 2008, the bubble dynamic burned out in what Hyman Minsky called the Ponzi stage of the financial cycle. Investors and speculators paid their backers by borrowing the interest—and even borrowing the hoped-for price gains for real estate, stocks, and bonds. Companies bid up prices for their own stock by using cash flow and even by borrowing—while increasing earnings by outsourcing production and downsizing employment.

Tax policy also favored making capital gains rather than earning wages, salaries, or profits. And the Federal Reserve was able to inflate asset prices by flooding the economy with enough credit to lower interest rates, enabling banks to capitalize a rental or corporate income at a higher multiple in lending to new buyers. What President George W. Bush euphemized as "the ownership society" was becoming an increasingly debt-leveraged economy. Raising home ownership rates for racial and ethnic minorities (and for low-income families in general) were achieved by loading them down heavily with debt at exploding "adjustable" mortgage rates.

Alan Greenspan urged homeowners who chose to stay in their property to "cash out" on their home equity by borrowing and spending the loan proceeds as if it were income. As wages and salaries had stagnated since the late 1970s while medical costs and other prices rose, such borrowing more against one's home became the only way of maintaining living standards for many families. The Protestant Ethic of living off interest, not eating into capital or going into debt, was becoming obsolete. Debt leveraging was applauded as the way to get rich.

But this created a policy quandary once the process had run its course by lowering interest rates and easing credit terms. If governments let interest rates rise again, this would cause losses in the capitalized value of real estate rents, corporate earnings, stocks, and bonds. So central banks were locked into low interest rates, such as the Federal Reserve's Quantitative Easing policy in 2010 and 2011.

This turned the dream of pension fund capitalism into a nightmare of insolvency. Financializing pensions by steering revenue into the financial markets to build up claims *on* the economy had an opposite effect from direct investment to earn revenue on a current basis. Pension funding helped bid up prices for financial assets while interest rates were falling. But when the bubble had run its course the economy was left loaded down with debt. Its carrying charges blocked recovery by diverting spending away from markets for goods and services.

DEBT DEFLATION IN THE POST-BUBBLE ECONOMY

Paying down debts raises the reported rate of saving, because the negation of a negation (lower debt) is counted as a positive (saving). This is the form that saving is taking in the US economy today: reducing credit card balances and paying down mortgages, student loan balances, and other obligations. This is not a buildup of funds available for spending. Most people have less to spend as they pay debt service. And they are less able to borrow as banks are pulling back their credit lines, seeing the economy become more risky and hence less creditworthy.

Economies shrink when debt service diverts spending away from consumption and investment. And as economies shrink, financial risks rise. Companies cannot borrow by issuing their own commercial paper IOUs, because the wave of deregulation has destroyed the trust needed for financial markets to work. And banks are not relending their inflow of loan paybacks to the "real" economy, but entirely to other financial institutions; or, they are rebuilding their reserves of government securities, or speculating on arbitrage gambles.

Credit has dried up even more drastically in Europe. An obsession with government budget deficits prevents them from supplying the economy with spending power. Decades of bank propaganda have implanted a false memory in Germany's population. The Weimar hyperinflation in the early 1920s is blamed on the Reichsbank financing a domestic budget deficit. What actually happened is that the central bank tried to meet Germany's unpayably high reparations by printing reichsmarks and desperately selling them on the foreign exchange market to raise the hard currency being demanded by the Allies. The problem was not domestic money creation to finance German spending, but war debts denominated in foreign currency.

Bankers have crafted a narrative that has drowned out memory of what actually happened in history—and also misrepresented how central banks are supposed to work in practice. In a bold attempt to deter today's governments from having their own central banks monetize their deficits, bank lobbyists and their pet academics parrot the absurd falsehood *ad nauseum* that central bank financing of budget deficits is inherently inflationary—indeed, hyperinflationary, likely to bring on economic collapse. The only "stable" policy, bankers insist, is for governments to borrow from them—as if they are "honest brokers" wisely lending only for economically viable productive purposes.

Even a cursory look at recent US and British experience should dispel the idea that central bank money creation must inflate commodity prices. The Bank of England and the Federal Reserve do what central banks were founded to do: monetize public budget deficits. This is what is needed to save economies from plunging into depression today—although, in fact, the deficits have stemmed from bailing out the banks and financial sector. Since 2006, the Federal Reserve has overseen the largest new money creation in history. Yet consumer prices and wages barely rose. Likewise in Britain, the pound has held steady, as has the dollar.

What *has* occurred is a debt-leveraged real estate bubble collapsing into negative equity. Yet Europe remains committed to austerity, pushing its economies deeper into depression. Latvia and Greece limp along as object lessons to show how financial and fiscal austerity leads to plunging employment, bankruptcies, collapsing property prices, and foreclosures. Labor is unable to find work and emigrates. So debts end in default and national budget deficits worsen.

Even as economies are being driven into debt deflation and depression, the "Troika" of EU leadership, the European Central Bank (ECB) and International Monetary Fund (IMF) are calling for balanced budgets instead of public spending to revive employment. Neoliberal ideology holds such spending responsible for the inability to pay creditors. It demands that governments pay by raising taxes on the nonfinancial sector—for bad private-sector debts as well as public debts.

Ignoring the problems caused by private-sector debt and bad bank lending frees the banks from blame, as if their lending were not the main cause of raising prices for houses and other assets. It adds injury to insult by demanding a "solution" that gives the banks a windfall. Neoliberals seek to use the financial crisis as an opportunity to push a grab bag of benefits. For starters, they urge that progressive taxation be abandoned in favor of a flat tax, excluding capital gains and other *rentier* income. The policy is to be capped by selling off public assets to bank customers. So banks are to be given even more subsidies to keep them afloat under their own bad-debt burden that has wiped out their reserves. These solutions would impose fiscal deflation on top of debt deflation.

Misrepresenting the debt problem as a demographic one, financial lobbyists point out that people are living longer. They then claim that governments cannot balance their budgets without slashing Social Security, just as the private sector has been downscaling defined benefit pension plans into amorphous "defined contribution" plans. (Wages are withheld in the hope that Wall Street money managers will make capital gains.) In this reading, the "solution" to the economy's debt overhang is not to write down debts, nor to restore progressive taxation and pay Social Security, health care, and other public spending out of the general budget. The social safety net is to be scaled back so as to reduce taxes and become more "competitive."

THE BAILOUT ECONOMY

In the single case where government budget deficits are urged to increase—indeed, soar to veritable wartime levels—the purpose is not to revive economies, but to bail out banks for the losses suffered from lending out more than realistically can be repaid. Bad bank loans are to be shifted onto the public balance sheet. *If the central bank is blocked from monetizing the cost by buying government bonds and thereby putting money into the economy* (something that current EU policy and the German constitution forbids the ECB from doing), *then taxes will have to be raised or public spending cut back drastically* (as in Ireland since 2010).

This anti-industrial, anti-labor policy rules out writing down debts to what can be paid under normal conditions—that is, paid without widespread forfeiture of property. Wealth is to be siphoned off to the top of the economic pyramid.

Someone must lose, of course—and the motto is "Big fish eat little fish," mediated by the government in today's financialized travesty of a "free market." Most fortunes in history have come from the public domain, after all. The first aim is to take government funding and bailouts and run. The second is to deter prosecution by turning campaign contributions into the right to name (or at least veto) the leading public administrators. For example Sheila Bair, head of the Federal Deposit Insurance Corp. (FDIC), argued that Citibank could have been permitted to go under without disturbing its basic consumer-banking operations. Known for "stretching the legal envelope," the bank had sufficient assets to back its insured deposits. What would have been wiped out was the financial web of cross claims and gambles among large institutions. Instead, Treasury Secretaries Hank Paulson and Tim Geithner gave Citigroup $45 billion.

They also bailed out the insurance and casino capitalist conglomerate AIG. It could have preserved its "vanilla" retail and business insurance operations, merely defaulting on its insurance contracts its London office had written for junk mortgages that ratings agencies marked AAA prime. The economy-wide tangle of collateralized debt obligations, cross default swaps and other "toxic waste" could have been wiped out, putting the "real" economy first. But the government paid AIG's counterparties $182 billion in 2008, followed by more giveaways.

A financial "free market" meant that ratings were up for sale, much as Enron-style accounting had corrupted Arthur Andersen. No large Wall Street institution received a single criminal charge or prosecution. Exorbitant financial bonuses and salaries hardly missed a beat while home foreclosures soared for the economy at large. The financial "fat" was saved even at the cost of destroying the industrial "bone." Interlocking conflicts of interest and non-enforcement of rules preserved the financial parasite at the cost of weakening the industrial host economy. Debts by honest home borrowers were left in place, but debts owed by defaulting financial insiders for bad gambles on which way prices, interest rates, and foreign currencies would move were paid to the winning bettors.

A similar financial favoritism occurs by permitting financial managers to threaten corporate bankruptcy to wipe out pension plans and health obligations. Contractual obligations to employees have been shifted (and downsized) onto the underfunded Public Benefit Guarantee Corp. (PBGC). The "sanctity of contracts" has become one-way, annulling obligations owed to labor. This is said to be a free market, but reflects the financialized takeover of the public sector.

THE AGE OF JUNK ECONOMICS

Classical economists set out to free Europe from its postfeudal legacy of *rentier* claims, and to define the surplus being siphoned off to pay a hereditary landlord class and bankers. But the *rentiers* mounted a counter-reform effort. Recognizing that voter preferences and public policy are shaped by perceptions of how the world operates, *rentiers* sponsored an effort to turn economic thought into science fiction describing a parallel universe. Switching attention away from empirical reality to "a science based on assumptions" takes the form of defining the task of economic "science" as being to provide a logic demonstrating that economies automatically regulate themselves. Attempts to restore a balanced public/private economy with regulatory checks and balances are defined as adding to the cost of doing business, *ipso facto*. The resulting tunnel vision dulls the mind from sensing the danger posed by the financial takeover. Economic theory is turned into an anti-labor, anti-government, and anti-regulatory exercise in public relations lobbying.

This inverts the idea of what the word "scientific" means. Neoliberal ideology deems it scientific to restrict analysis, theory, and model building to how economies would work without any government policies. Such policies cannot be "universal" in the same sense as the laws of physics and chemistry. Tax laws, government spending programs, and other institutions differ for every country, giving much leeway for choice. Emphasizing abstract universals excludes at the outset what should be the object of political economy: national policy and changes in the institutional and fiscal framework.

The resulting orthodoxy describes how a hypothetical economy would work if it had no real central bank, if it privatized basic infrastructure and offered its services at cost (including normal profits) despite deregulation of price controls and abolishing anti-monopoly regulations, and if it does away with consumer protection and anti-fraud statutes. Monopoly power is called "free competition" as long as stocks in monopolies can be bought and sold by anyone, domestic and foreign alike. More specifically, the kind of "scientific" mathematics being employed limits its variables to wage levels, government deficits, and consumer prices, so as to endorse a race to the bottom—and indeed, to imply that "there is no alternative" (TINA). In practical terms, this mathematical "garbage in, garbage out" (GIGO) exercise means no hope for change in the status quo, no hope for countries falling into debt except to accept their dependency on their creditors.

In contrast to the natural sciences that start with empirical reality, neoliberal economics starts with fiction and reasons deductively from a set of carefully selected assumptions designed to prove that public investment and other spending is wasteful, regulation and forward planning are burdensome and ineffectual. The inevitable conclusion, reached purely deductively, is that bankers should be left to decide how to allocate the economy's resources.

This logic begins by choosing assumptions that will lead to the conclusion being sponsored, and working backward. The cooked conclusion is that economies get rich by cutting social spending (defined as an "interference with the free market"), dismantling government regulations (except for the central bank, which is to be controlled "independently" by the financial sector and given veto power over all other public agencies), and charging user fees for education, health care, and other public services. Wages are to be lowered in order to increase competitive export power to earn the money to pay creditors, on the assumption that this will not reduce labor productivity.

Banks are to act as the economy's planners, as if this is not more centralized than planning by elected officials. Public office itself is to be made part of the "free market" by permitting campaign contributions by Wall Street and other business lobbyists without limit to buy TV and media time, and endow public relations "think tanks" to shape voter opinion, along with business schools to craft a body of airy mathematics purporting to demonstrate that neoliberal counter-reforms are efficient. Lenin may not actually have coined the term often attributed to him to describe such people, "useful idiots," but the phrase certainly is apt.

This is the logic that rationalizes privatizing land rent and public monopolies on credit instead of taxing or socializing their ownership privileges. Banks, mineral resource ownership, basic infrastructure, and monopolies have been organized into corporations selling shares. They have become the new "land barons." Their claims for economic rent and financial returns can be passed down to the heirs of whoever buys them. So *rentier* income is still being concentrated at the top of the economic pyramid, albeit in the hands of a postfeudal creditor class. The new mode of conquest is financial, no longer overtly military. Unless, of course, countries resist being "financialized." In such cases they are isolated by sanctions, Cuba- or Iran-style.

The trick is to distract attention from how debt deflation shrinks economies and dries up new investment and employment. And when resources *really* become scarce, economists call it a crisis. This usually is the point where they agree that the time has come to suspend democracy and bring in the "technocrats" (a euphemism for bank lobbyists), as they did in Greece and Italy in 2012.

All this has reversed the direction in which Western civilization was moving until World War I. Economies are retrogressing toward pre-Enlightenment *rentier* societies. The classical ideal of regulating prices in line with cost-value is now denounced as an exercise in bad "statist" economics. It is as if the past three or four centuries have been a great mistake—what Frederick Hayek called a road *to* serfdom, not away from it by limiting *rentier* power.

This reaction turns the idea of free markets into the opposite of what classical economists meant—a market free of unearned income. Prices and incomes were to be brought in line with cost-value. The "unearned increment" was supposed to be taxed away: land-price gains (groundrent), mineral rents (provided by nature and rightly treated as national patrimony), and what manmade monopolies charged over and above normal profit rates for providing their services. Governments would invest the tax revenue from economic rent in infrastructure providing basic transportation, communication, and other services at subsidized prices, and ultimately freely, just as already was being done for roads, public education, and health.

As governments provided a widening range of infrastructure services, industrial capitalism in the classical economic vision was expected to evolve into socialism. In Britain, Prime Minister Benjamin Disraeli's social welfare legislation was capped by the public health system introduced from 1874 to 1881 and promoted under his motto *Sanitas sanitatum*, "Health, all is health." This helped the Conservative Party evolve as a nationalist, sometimes "state socialist" party, especially after World War II under Harold Macmillan in the 1960s. In Germany, Bismarck enacted a pension plan for the population at large, not just army members as in times past.

By contrast, today's financial interests use the mathematical language of physical scientists to pretend that austerity will cure the government's budget deficit and balance of payments. The reality is that a shrinking economy is *less* able to pay taxes and debts. Upon any truly empirical scientific examination, neoliberal logic is a public relations tactic in today's financial war against society at large. The aim is to lock in power the way Rome did: by reducing as much of the population as possible to debt dependency.

And just as in Rome, today's debt overhead cannot be paid. The question is, just *how* will it not be paid? Will society realize the need for debt write-downs, or will it permit massive foreclosure to tear society apart and reduce debtors to neo-serfdom?

Today's bankers explain that debt crises should be solved by yet more lending, as if this will "get economies moving gain." It is as if economies could borrow their way out of debt. If we are indeed to take Germany's hyperinflation as paradigmatic, as bankers argue, we must recognize that the mark was stabilized in the same way France had paid after the Franco-Prussian war ended in 1871: by borrowing. German states and cities borrowed dollars in New York, and converted them into marks that the Reichsbank printed. It then used these dollars to pay the Allies—who turned around and paid them back to the United States for their arms debts stemming from World War I. The illusion of stability was achieved simply by running up private-sector debt (to US bondholders) to replace intergovernmental arms debts and reparations.

This was just the opposite of today's European and US taking bad *commercial* bank debts onto the *public* balance sheet.

In 1931, the pretense finally was ended by a moratorium. This must be how today's debt overhead also must end because debts that can't be paid won't be. Trying to prolong the day of reckoning will only impose an interregnum of austerity during which the financial sector will extract as much revenue as it can get away with, and foreclose on as much property as society will permit. Making itself a new ruling elite to lord it over what remains of the 21st century, Wall Street's conquest promises to join Spain's conquest of the New World and the Nordic conquests of Europe—and is in much the same spirit as Rome's conquest of its Empire two thousand years ago. The results for society at large threaten to be equally devastating today.

FROM DEBT PEONAGE TO NEOFEUDALISM

Today's finance capitalism is more impersonal than the Viking conquests that parceled out Europe's land among the conquerors. In due course the land, natural resources, and monopolies that feudalism privatized were sold to banking families that lent money to fight for more property and trading rights. Appropriating and expropriating resources is now an autonomous financial dynamic, working more covertly and even in a more democratic political context than military conquest. An almost impersonal array of banking institutions replaces seizure by force of arms.

Unlike serfs, debt peons are free to live wherever they wish—or at least wherever they can afford. They may buy land by taking out a mortgage and paying its rental value to the bank. But wherever they live they take their debts with them, from student loans to credit card debt.

Also unlike military warfare, financial conquest does not kill people directly. It is much more genteel. Debt deflation causes poverty, discourages family formation, marriage and birth rates, and shortens lifespans. This prompted Vladimir Putin to note that neoliberal policies and privatization along kleptocratic lines had destroyed more of Russia's population since 1990 than the nation had lost in World War II. Instead of the "Seven Boyers," Russia had its "Seven Bankers" after Boris Yeltsin's 1994 loans-for-shares privatization of the nation's most valuable natural resources and monopolies.

Rome's creditor-oriented economy collapsed into the Dark Age, plunging the Empire into debt peonage. It became the first major society *not* to cancel its debts. Predatory legal and political systems drive populations into debt, yet may survive longer than mathematical models would expect, despite infrastructure falling apart and employment drying up. It took from the first century BC's Social War (133-29 BC) to the fourth century AD turning point for economic life to decentralized and revert to self-sufficient landed estates.

Today a similar problem of debt deflation is polarizing society and imposing austerity, drying up the internal market. The dream of bank marketing departments, after all, is for all disposable income (over and above spending on basic needs, to be kept to the minimum) and corporate cash flow to be paid as debt service. During the upswing of debt, this was called "treating your home like a piggy bank" by taking out an equity loan. But that was not a fair analogy. Buying a home has become a means to drive populations into debt. And now the debts remain in place, leaving the banks with the power—which they have used to buy control of governments.

Unless the world changes its path, the "final" stage of finance capitalism threatens to deteriorate into debt peonage so widespread as to become neofeudalism, relinquishing control of the economic surplus to a financial elite making itself as hereditary as the old landed aristocracies.

IT DOESN'T HAVE TO BE THIS WAY

In addition to the moral fairness of bringing prices in line with cost-value so as to free society from special privileges that create "unearned" *rentier* income without work, classical economics was a guide to making societies more productive and efficient. Governments seeking to nurture their national industry saw it as a strategy for how to modernize. So the same logic that evolved into socialism via Saint-Simon, Marx and other reformers provided the model for the industrial classes to make France, Germany, and other economies more competitive so as to overtake Britain in the 19th century.

As noted above, the thrust of classical political economy was to free society from *rentier* charges that simply added "empty" pricing to the cost of living and doing business: land rent, monopoly rent, and financial charges. The major beneficiaries of reforms designed to minimize these economic rents were industry and labor. Pro-labor reformers characterized themselves socialists, and pro-industrial reformers often have been characterized as "state socialists." Despite their opposing class interests in terms of employer-employee relations, they shared a common interest in freeing society from the heavy overhead rents extracted by landlords, monopolists, and the financial sector.

These special *rentier* interests sought to remain free of rent taxes and price regulations. To them, a "free market" was one that was free for their unearned income to remain free *from* public taxation. This led them to oppose government power, at a time when democratic politics was aligned against them and was minimizing the ability of the House of Lords in Britain and upper houses in other nations from blocking progressive taxation and its associated classical policies.

The classical program of free markets—that is, markets free from prices in excess of cost-value—was to tax land rent (or at an extreme, nationalize it), and to keep basic infrastructure and natural monopolies in the public domain so as to provide basic services at cost or at subsidized rates. This meant a mixed economy, not only a one-sided private sector. An active public sector was to absorb the cost of infrastructure, education, health care, and pensions—mainly by taxing the rental value of land and natural resources.

One of the most systematic defenses of this policy was voiced by Patten, mentioned above as the first professor of economics at the Wharton School of Business at the University of Pennsylvania from the 1880s up to World War I. He described public infrastructure as a "fourth factor of production," whose return was measured not by the profits and price markup it made, but by its ability to lower the national price structure. This was the strategy that guided industrial development in the United States, Germany, France, and Japan. These and other nations provided a widening array of basic infrastructure services at subsidized rates, and indeed free of charge, *e.g.*, roads, education, and so forth. Likewise, public money creation—most notably America's greenbacks issued during its Civil War—would save taxpayers from having to pay bondholders. Patten's term "Economy of Abundance" held out hope for an overlap (or at least an olive branch) between industrial "state socialism" and labor socialism. Both lines of development were based on value, price, and rent theory applied on a national level in a mixed public/private economy.

In the monetary sphere the thrust of this movement was more diverse but centered on replacing interest-bearing debt with equity profit-sharing arrangements, and on public money creation replacing private bank credit. Lending was to be productive. In the sphere of public debt, the way to minimize an economy's fiscal overhead was to refrain from wars. Since the time of Adam Smith, the logic of free market reform was one of peace. The rivalry that was envisioned was commercial, between old-style *rentier* economies and reformed “statist” economies.

When World War I broke out, there was widespread belief that complex industrial economies could not afford war. Many economists forecast that the Great War would have to end in just a few months as countries ran out of money. But governments soon discovered that central banks could create much more money than was anticipated. As the United States had shown in its own Civil War half a century earlier, it was not necessary to tax *or* to borrow.

The implication was that an all-powerful commercial banking class was no more necessary than a dominant landlord class. Taxes were not necessary so much to finance government as to tax unearned income to preserve a fair society and prevent vested special interests from developing. This is the thrust of Modern Monetary Theory (MMT), centered at the University of Missouri-Kansas City and allied schools. This line of analysis was not pressed by the victorious Allies, nor was it retained in Germany. By the 1920s, an alternative to the classical economic reform program was being crafted by the *rentiers*.

In fact, by the time America succeeded in surpassing Britain as an industrial power, it had little interest in promoting its protectionist public investment policies in other countries. Its strategists wanted to “pull up the ladder.” By the 1980s, the classical economic reform program had become consigned to the realm of unhistory, excluded from the academic curriculum.

The new idea of competition was based on privatizing infrastructure on credit, just as real estate ownership rights were sold. The definition of good management was to create rent-seeking opportunities—financed by interest-bearing debt. Education, health care, and medicine were to become privatized as rent-extracting opportunities. Pensions were to be financed by saving in advance and living off the interest or capital gains achieved financially, not necessarily industrially.

If this “future” had been forecast a century ago, most economic observers would have found it so unlikely as to be unbelievable. Their first question would have been how an economic system can win if it is made high-cost rather than low-cost? Would not basic competitive forces bring about a world free of *rentiers*, a peaceful world with less class warfare between these old postfeudal classes and the “real” economy of industry, production, and consumption?

No major economic writer expected the *rentier* classes to fight back with any great success beyond protesting that taking away their privileges was akin to communist dictatorship.

And indeed, who would have thought that libertarian or "Austrian" ideas of a stateless economy (dominated by *rentiers*, headed by bankers) would spread beyond navel-gazing academics living in an "as if" world? Governments were moving toward progressive income taxation, investing in infrastructure, and establishing public banking and monetary systems.

But the counter-reform movement has convinced many voters and public officials that there is indeed no alternative. To make sure that this will be the case, history is being rewritten, above all that of economic thought. Pro-*rentier* lobbyists recognize that to impose their travesty of free markets, they need totalitarian control of the academic discussion, censorial power over the press, and ultimately the threat of violence. This is what the Chicago Boys realized in Pinochet's Chile with their 1973 dress rehearsal for neoliberal policy. Their first act was to close down every economics department in the country, and inaugurate a Latin American assassination campaign, Operation Condor. This is the Inquisitional side of free-market economics.

Today's creditor interests are pursuing much the same road to feudalism that Rome followed two thousand years ago when its oligarchy initiated a century-long Social War (133-29 BC) by political assassination and widespread violence. This was by no means an exercise in creative destruction. It ended up indebting the citizenry and left imperial looting ("spreading peace") as the last available gain-seeking opportunity in a shrinking economy.

THE MAIN SOURCE OF ECONOMIC IMBALANCE AND POLARIZATION, AND POLICIES TO COPE WITH IT

Credit—and hence debt—obviously has been needed since a specialization of labor developed with the seasonal rhythms and gaps between planting and harvesting in the Neolithic agricultural cycle. It is implicit wherever there is a time gap between initial investment and the final product being delivered and paid for. Interest is first documented in the third millennium BC as a way for Sumerian public institutions to estimate their fair share of their gains on commercial advances to traveling merchants.

Most agrarian debts were also owed to royal collectors, mainly for land rental fees, water and shipping, and consumer loans. When this "barley debt" overhead grew too large, early Near Eastern rulers restored order with Clean Slates annulling these unpaid charges. Rulers were under no illusion that their economies automatically would settle in economic and financial balance. Instability was inevitable from natural disasters and wartime disruption, and simply from interest accruals increasing the debt balances quickly beyond what debtors in low-surplus economies could pay.

Administrators were not so idealistic or utopian as to attempt to design a system that somehow would not get out of balance. The archaic approach was to deal with the inevitable insolvency when it became necessary to annul consumer debts. The fact that most debts were owed to palace and temple collectors meant that the authorities were basically cancelling debts owed to themselves. (Commercial silver debts for productive loans among merchants were left in place.) These Clean Slates restored order in times of natural disaster or emergencies, and also when new rulers took their first full year on the throne. The aim was to inaugurate their reign with the economy in balance, by clearing away the accumulation of unpaid obligations that had built up as a result of an inability to pay.

Realization that there is no inherent tendency toward equilibrium (much less an equitable balance) is missing from today's theorizing. Equilibrium mathematics based on diminishing returns and marginal utility (while ignoring compound interest and its growing debt burden) is irrelevant at best, and at worst a deliberately engineered distraction. When we see unrealistic economics built on false assumptions maintained in the face of repeated failure, we must look for special interests as the beneficiaries.

So just as industrial engineering has given way to financial engineering, *rentier* lobbying has given way to ideological engineering to shape perceptions of what is happening—because the diagnosis determines the policy cure. As economies veer out of balance and polarize, *rentiers* aim to deter economies from doing anything to prevent this widening imbalance. They pretend that "automatic stabilizers" will restore normalcy. But no such stabilizers are strong enough to rectify financial imbalance and predatory behavior. Antiquity was able to avoid polarization for many thousands of years precisely because it was free of such preconceptions. These are only a century old, promoted by the anti-classical reaction against Progressive Era reforms.

In behavioral terms, today's targeted dulling of perceptions that something is drastically wrong with the economy's health is similar to what parasites do in biological nature: They numb the host's ability to perceive that a free rider has taken over. The economic equivalent is Milton Friedman's popularization of the science fiction writer Robert Heinlein's motto, "There is no such thing as a free lunch." What better way is there to deter the study of just how much of the economy is indeed a free lunch (economic rent), who gets it, and who is being exploited?

Parasites love deregulation—as the financial sector loves “free markets.” There is no room for the study of economic rent in the marginal utility approach to pricing or the Austrian economics sponsored to replace classical value theory. Denying that there is any such thing as unearned income or wealth, the new ideology seeks to erase the contrast between fair and equitable pricing and taxation as compared to exploitative rent extraction or, for that matter, the outright fraud that has become almost part and parcel of today’s financial sector.

Biological parasites trick the host into believing that they are part of its own body, even to be nurtured as if they were its offspring. But what actually is being reproduced is the parasite’s own life cycle. The economic equivalent of this favoritism for the free luncher occurs when interest is made tax deductible so that the financial sector can obtain more revenue to nourish its growth at the expense of the nonfinancial host economy. It occurs also when the Treasury favors debt over equity financing, and taxes financial gains from asset-price inflation and speculation (“carried interest”) at only a fraction of the rate levied on earnings from tangible capital formation, wages, and salaries.

In biological nature a smart parasite will keep the host alive and even help it find new sources of food, and perhaps keep it disease-free in a symbiotic relationship. The aim, of course, is to obtain most of the nourishment for itself and its offspring, over and above the basic subsistence level needed to keep the host alive.

But parasites shorten their time frame as they approach the end stage of the relationship with their host. Realizing that the game is nearly up, the free luncher does the equivalent of taking the money and running. It may encourage its host to act recklessly and be eaten by its own natural predator. A parasitized insect, for example, may lower its defenses and be eaten by a bird, which will become the new host for the parasite’s eggs to hatch within it. The parasite’s progeny will start a new life, higher in the food chain where the numbed and value-free host has ended up being “globalized.”

Alternatively, the parasite lays its eggs in the host directly, to hatch and devour its body as their food supply. This is essentially what occurs when the inexorable mathematics of compound interest absorbs the “real” economy’s profits, disposable personal income, and tax revenue. Since economies were stricken in September 2008, the financial sector has adopted a hit-and-run business plan, using its control of the host economy’s brain (government agencies, above all the Treasury and Federal Reserve) to give it bailouts, and threatening to paralyze the host economy by stopping its circulation of payments if it does not get its way.

Today's financial free riders are abandoning ship to enter into a new symbiosis with new host economies. By the time the Federal Reserve gave the banks 800 billion dollars in QE2 in 2012, most was spent in the BRIC countries and other healthy targets via exchange rate and interest rate arbitrage. The financial game plan is to numb the defense mechanisms of China and other less financialized countries the way neoliberals did to Russia in the 1990s.

What will happen to the host economies left as emptied out shells? Will the Untied States and Europe simply be left nearly for dead, having been turned into zombies by being financialized?

Today's industrial host economies stand at a crossroads over this problem. To survive, they need to reverse the disabling of their regulatory defense mechanisms. The first step must be to revive classical political economy's distinction between cost-value and price. The labor theory of value was an analytical tool to isolate economic rent as the element of price that has no necessary cost of production—"unearned income" because it has no counterpart necessary cost of production.

To bring prices in line with cost-value called for a revolution against feudal privileges in Europe and the regions it colonized. On the eve of World War I, the reform program seemed to be succeeding. But it was rolled back when the "real" host economy had its analytic perception and regulatory warning organs disabled.

Suppose the host economy wakes up and senses what is going on. How is it to translate this perception into action in the political, law-making, and fiscal sphere?

In Europe, Parliamentary reform was expected to be the political catalyst, assuming that voters would act in their enlightened self-interest. Britain cleaned up its "rotten boroughs" in the 19th century, and the constitutional crisis of 1910 was resolved by an agreement that the House of Lords could never again block a House of Commons revenue bill. The way was freed for reformers to tax unearned land rent.

However, *rentier*-backed demagogues have relegated the classical emphasis on the fiscal and monetary dimension of political economy to merely a secondary position. Elections are fought over ethnic rivalries (in the Baltics and the American South), conservative horror at the thought of legalizing women's rights and sexual equality (in right-wing religious areas and white collar urban precincts), or "democracy" (in US protectorates abroad, where the term has become synonymous with pro-US regimes rather than reflecting any particular political system). This calls into question the optimistic Enlightenment political premises of full knowledge of what is happening and enlightened self-interest as a guide for action.

If most voters are to act in their self-interest, this requires a revival of the logic that underlay the Progressive Era's reform program. It must start by re-establishing the grounding of 19th century discussion in value, price and rent theory, the tax policy that follows from it, and monetary theory as it applies to financing public budget deficits.

Chicago School censors exclude such discussion from the journals and the curriculum where they hold sway—not always at gunpoint as in Chile, but more simply by controlling young professors' access to tenure-track positions under "publish or perish" in journals fallen prey to *rentier* intellectual numbing and blind spots.

The result may seem ironic, because it has left the critique of pro-*rentier* markets "free" from public regulation and investment, and from progressive taxation, and predatory finance has been left mainly to Marxists. The explanation is that, as Patten pointed out, classical economics culminated in Marx (and in Henry George's advocacy of taxing land rent). Marx and the socialists simply pushed the classical analysis to its logical conclusion in using the labor theory of value to isolate economic rent as unearned and hence unnecessary income—and applying this concept to banking and finance (which Ricardo never did!) as well as to land ownership and monopolies.

The classical focus on freeing markets from technologically and socially unnecessary overhead charges frightened high finance and its *rentier* clients, inspiring them to back an anti-classical reaction. Economic theory and ideology remain traumatized by this conflict between these *rentier* interests and those of industrial capital and labor. This trauma has become political, and is now challenging the core of how Western civilization has defined its postfeudal identity since the Enlightenment.

The underlying conflict between creditors and debtors has happened ever since antiquity succumbed to the post-Roman Dark Age. A negative equity economy is one that is losing blood—in economic terms, the circulation of income is drained to pay debt service. And the financial sector that receives this revenue behaves much as rats jumping ship or parasites steering their host to be devoured, or simply devouring them directly from the inside.

This is the state in which today's debt-ridden economies are suffering, from Iceland and Latvia to Greece and Ireland. The deadly demographic effects are emigration, falling family formation and birthrates, shortening lifespans, and rising suicide rates.

This is not a natural death process. Yet the financial sector blames it on demographic aging. It blames budget deficits not on cutting taxes on real estate, finance and other wealth, but on the elderly for trying to enforce payment of the Social Security and pensions they were promised and for which they pre-saved in their wage agreements. Yet the productivity gains since World War II—or indeed, since 1980—have been large enough to support these payments and, for that matter, the leisure economy that was promised.

The problem is financial disease. It gained its initial foothold by crippling the guiding hand of government's forward planning and regulatory mechanisms, and replacing progressive taxation and rent collection with favoritism over industry and labor. So the fight is not really a demographic one between the elderly and the "working population." It is between employed labor and retirees together vis-à-vis an extractive financial elite allied with real estate and monopolies.

The fight is being waged over who will control government, its tax, and its regulatory system. In the political sphere, it is between economic democracy and financial oligarchy. This is the struggle that classical economics set out to arrange and quantify in order to design an appropriate cure aimed at creating amore equitable society and doing away with "false" and unnecessary *rentier* costs of production. Today's neoliberalism is just the opposite: it seeks to load economies down with debt extracting interest beyond their ability to pay, and then demands privatization of public infrastructure to create monopolies to serve as further rent extraction.

This is what the European Troika has demanded of Greece. Its product is austerity, and it threatens to impose a new economic Dark Age.