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US vs China Housing…and Those Millennials

The Hudson Report is a new weekly series produced by Left Out with the legendary economist Michael Hudson. Every episode we cover an economic or political issue that is either being ignored—or hotly debated—that week in the press.

Paul Sliker: Michael Hudson welcome back to The Hudson Report.

Michael Hudson: It's good to be back. I'm just home from China, getting over jetlag.

Paul Sliker: You recently gave a paper at Peking University about the economy and what sorts of policies they should implement and what to avoid.

But Michael, because we only have a short amount of time in these weekly segments, I want to look specifically at housing in China, and then compare that to what's going on here in the U.S. In your speech you argued that China's most pressing policy challenge is to keep down the cost of housing and that the policies best suited to avoid what you call the "neo-rentierdisease." Can you give us a picture of what's going on currently with housing in China, and then explain what you mean by "neo-rentier disease" and how the Chinese can avoid it.

Michael Hudson: To put this in international perspective, you could say that international competition is based on labor's cost of living in each country. The most important expense in every country's cost of living today is housing. What makes a country competitive in manufacturing or other sectors comes down to how much it costs to pay for housing.

20 or 30 years ago only 10 percent to 12 percent of one's income had to go for housing. That's about the ratio in Germany today. But in America today it's over 40 percent in the big cities. It's also over 40 percent in London, and and it's rising throughout Europe. But

this is not a force of nature. It doesn't have to be this way. It's largely because banks have found that they can do to housing the same thing they've done to education: Housing is an excuse to get people into debt.

The most important way to get people into debt for housing is to take control of the government with your lobbyists to un-tax housing. The property tax is way less than the rise in land prices. That leaves the rising rental value available to be paid to the banks. The reason why housing prices are going up is because a house is worth whatever a bank will lend. And they are lending more and more, to enable new borrowers to bid up property prices.

You'd think that China would have learned this by looking at the West, or at least by reading Volume 3 of *Capital*. In fact the Peking University meeting, the Second World Conference on Marxism, David Harvey gave the opening and closing speech. His point was that the Chinese should read Volume III of *Capital* to understand why and how the volume of debt and credit grows exponentially. As banks get richer and richer, the One Percent get richer. They need to nurture more and more markets for their credit and debt creation. So they lend on easier and easier terms, at a rising proportion of the home's value. So it's bank credit that has been inflating the price of housing.

David Harvey asked how China can let the price of housing go up so high in Shanghai (the most privatized city) that almost everybody who has a house is a millionaire. How can China expect to remain competitive in exporting industrial products when the cost of housing is so high?

Unfortunately, his talk and mine were almost the only economic talks at the meeting in Peking. As one of the Russian attendees pointed out to me, "Marxism" is the Chinese word for politics. "Marxism with Chinese characteristics" means to doing what they want politically. But economically they've sent their students to the United States, to attend business schools to learn how U.S. financial engineering practices.

Shanghai is where Milton Friedman and the Chicago Boys came in the 1970s and early 80s, because the Chinese government worried that if western Marxists came over, they would tend to interfere with domestic Chinese politics. So actually, China had less exposure to foreign Marxian economics than to U.S.-style neoliberal teaching.

I gave the same basic talk in neighboring Tianjin, which is a more interesting city in many ways. It's where Chou En-Lei went to school. Talking to women students (about 80 percent of the economics students were women, because it's considered a social science there) about how they planned to get an apartment, I was told that they would have to marry a boy whose parents gave him an apartment. I didn't meet any male student who said he would have to marry a woman with her own apartment. It's a male's role to have an apartment for his wife. So if you can't find a guy with his own apartment this is not going to lead to a happy married life, and there may be no marriage at all.

Some of the students that I talked to three years ago are graduating now, but are still not married. So I asked where they were going to live. One of the problems I found out – in addition to what we just talked about – was that in order to prevent a rural exodus to the big cities, people from the provinces or from small towns are not allowed to get a passport to live in these cities. They're only allowed to buy apartments in their home town. China is trying to prevent overcrowding and the development of slums. As a result, in order to get an apartment the student decided to teach at a university or the high school that provides its own housing.

So China's corporations, public universities and other institutions are doing much what the Russian Soviets did: Employers provide their own workers with housing.

Meanwhile, you've had a move in the last three years under President Xi against corruption. The way they've moved against corruption is to put in a bureaucracy to prevent it. That is a natural step in any country. The bureaucracy has put a short lease on what governments can spending. So most universities, if they have big conferences, need a private-sector participant to share in the cost, especially if they bring people over from abroad. At the worse, this shifts corruption from the public sector to the private sector.

Meanwhile, there's a shift going on in China now, and the political attitude of the students I talked to is quite different from what it was a decade ago, when students really thought that they could change the country and get rid of corruption. OK, they've cracked down on corruption. They put in bureaucracy. But now they're faced with a problem that their students have all been sent to America to study economics and come back and ask "How do we get a free market?"

I couldn't believe that students in China were asking me about a free market. But that idea led President Xi a few months ago to say they're thinking of letting in American and European banks. Well, I think this would be a disaster. If you let in the American and foreign banks, their product is debt! What are they going to lend money for?

The answer is that they're going to lend more money to buy apartments than other Chinese banks are willing to lend. That's how banks increase their market share – a race to the bottom, into deeper and deeper debt. The new banks will lend on easier terms, with lower down payments. That provides buyers with even more credit to bid up the price of real estate. The effect will be to start pricing China out of the market.

So this is a self-destructive move by China. Property is worth whatever a bank will lend, and foreign banks are going to be as aggressive as they were in America. What the Chinese don't get is that the business plan of U.S. banks is fraud. Bill Black showed that in his analysis of the 2008 crisis. The junk-mortgage collapse was basically a fraud crisis. It may be repeated in China. In any case, it is a Trojan horse to financially bid up the price of housing, and maybe even education and anything else the banks can make loans on. That would make debt service so high that Chinese workers won't be able to be hired to produce goods that are competitive internationally.

Paul Sliker: I wanted to ask you specifically about the issue of debt in China. Their private debt bubble is basically the biggest in the history of capitalism. I think the 2017 numbers had it at about 220% of GDP. So what do you think is going to happen there with the broader economy?

Michael Hudson: Under current conditions nothing. It's not a problem. Here's why: The debts are owed to government banks. A government can do what the U.S. can't do. The government can forgive debts, at least those that are owed to itself, without creating a political backlash. If a viable corporation has run up too much debt, the government can forgive it. This is better than letting the debt close down a factory or force it be sold to a predatory asset management firm as occurs in the United States. That is the advantage of having public credit and why credit should be public. That's how it was in Babylonia. Rulers were able to cancel debts all the time in the 3rd millennium and 2nd millennium BC, because most debts were owed to the palace or the temples. Rulers were cancelling debts owed to themselves.

China can cancel business debt owed to itself. It can proclaim a clean slate. It can minimize debt service to whatever it chooses. But imagine if Chase Manhattan and Goldman Sachs are let in. It would be much harder for the government to raise real estate taxes leading to defaults on the banks. It could save the occupants by making new loans to those who default – based on lower land prices.

Well, you can imagine the international furor that would erupt. Trump would threaten to atom bomb Peking and Shanghai to save his constituency. His constituency and that of the Democrats are the same: Wall Street and the One Percent. So China may lose its ability to write down debts if it lets in foreign banks. That was what the big political discussion was when did discuss economics at the Chinese Academy of Sciences in Beijing and in Tianjin, where we're going to have a conference on Fictitious Capital in October.

Paul Sliker: Michael I know you briefly explained this a bit earlier in our conversation, but when we were emailing today about doing this segment, you tipped me off to a new book by the London-based economist Josh Ryan-Collins. He essentially shows that unaffordable housing is not a part of nature. That's counter to the way most people believe that housing actually works. Can you explain that in more detail?

Michael Hudson: Yes it's natural for people intuitively to think that housing prices are going up because people have more money to spend, or that the population is going up. But housing prices are going up even where population isn't, like in London or Australia. The reason prices are going up is that banks are making more and more reckless loans. They've lowered the down payments. They've stretched out the mortgages to interest-only mortgages (no amortization payments!) and they've basically convinced government to pick up most of the costs.

Once you're able to packagemortgages and sell them to somebody else, the bank doesn't care whether or not the buyers can pay. So you can have someone without a job, without an income, or with no assets at all (the NINJA borrowers that were infamous in 2008). If you lend them a million dollars to buy an apartment, they're can live there for a few months and then default if they can borrow 100 percent of the mortgage, as they could in 2008. But that's going to bid up the price of everybody's apartments.

Something like that has has happened in London. It's happened throughout Europe. It's happened in New York. It's happened throughout most of the United States. The price of housing is rising, but not because people are more popular or prosperous. They're paying more and more of their paycheck for housing. And as we've discussed before, that forces them to cut back on their other consumer spending, so that they don't have enough money to spend on goods and services.

That's why now you're finding whole buildings like 666 Fifth Avenue that Trump's son-in-law Kushner owns. It's reported to be 40 percent empty. He had to go to Qatar, right near Saudi Arabia, and promised to make US foreign policy serve it if its rulers would give him a loan to bail out his building. So you're having New York commercial real estate being bailed out by Trump's foreign policy.

And also, you're having business rents in New York going down because there's no one to buy stuff in the stores, because they have to spend so much money on the apartments they rent just to live in New York City or its environs.

Paul Sliker: This is a good transition to what I want to ask you about millennials and the U.S. housing market. A good chunk of our listeners are in the millennial generation. Some of those people have reached out to us, knowing that we do these weekly episodes with you and have wanted to get your take on the state of the U.S. housing market. I know you just shared a little bit about it.

I presume they want that information because some of them are straddling that line. Maybe they make just enough to afford housing, but it's still a pretty daunting investment. A lot of younger adults are still scared about what they saw happen, maybe to their families, neighbors or communities during 2007-2008. By the numbers millennials are buying less than older generations – and lots are rejecting the notion that they need to buy a home.

There's still a profound cultural impression here in America that owning a home is a good investment, the ultimate symbol of prosperity, success and tangible proof that you're living the so-called American Dream. But some people who have reached out to us have been so forthright to ask point-blank: "Can you ask Michael Hudson whether it's worth it or a safe investment for me to get into the housing market?" Of course, there's no blanket answer here. People's personal finances, where they're looking to buy the home, how much other types of debt they might be in, all would play a role in assessing that.

But excluding the trust fund babies – who are wealthy enough to buy a house without batting an eyelash – what could you say about the U.S. housing market right now to someone who is young and who is genuinely torn on whether to take out a mortgage on a house, to inform them on how to make that decision a little bit better?

Michael Hudson: Well, first of all as you just hinted, there are two classes millennials now. One class of millennials inherits houses from their parents, or have a trust fund or the parents have paid for their education in full and have helped them get a house or have given them their own house. Those are the millennials that have housing. But I don't see how the rest of the millennials can get housing, especially if they have a student debt, because the banks are now subject to higher lending standards. These higher standards mean that if you already have to pay 15 to 20 percent of your income for your student loan or other bank debt, you're not going to have the 40 percent of your income left to spend on the mortgage. That is what it takes now that we just raised interest rates last week to 5.3%. Banks are not going to lend you as much money as they used to. New buyers now have to actually have to make a substantial down payment, and pay off the mortgage in a shorter time. So unless the millennials can get their parents to co-sign, it's not going to be practical for them to buy a home.

It's not a generation gap as such, because rich millennials who have parents helping them are in one class, and self-supporting millennials (which used to be just about everybody in their late 20s) can't afford to be self-supporting anymore, even in their 30s. If you are self-supporting and do have a job, you certainly can't ask for a raise, because you could be escorted out quickly. And you can't go on strike because then you would miss the mortgage payment and lose your house. So you're painted into a corner.

So sure, housing is a good investment if you have millionaire parents. But if you don't have millionaire parents you're stuck. Don't worry if you can't get a bank loan. The market has really become extreme.

The problem is, how to rent in New York City, where the average rent is $4,500 a month. They'd have to move out to the suburbs with a roommate. So here you have the problem that China solved: the student debt problem. Basically the US government should abolish the student debt. That would enable this class of millennials to use their money to make a down payment for an apartment and actually get a place to live, like everybody for the last hundred years has been able to do.

I don't think people realize the radical damage that Obama did to the economy by bailing out the banks and not rolling back the terms of bank credit to keep housing affordable. Obama basically said, "Make housing unaffordable. Make as many junk loans as you want. Don't worry, because I'll stand between you and the mob with the pitchforks." He didn't jail any bankers. He didn't regulate them. He created the situation that Trump inherited. Trump has just pushed it to a further degree, with full Democratic support. The Democratic donor class loves Trump. They want him to be reelected because he's cutting their taxes, he's deregulating their banks, and he's essentially deregulated fraud!

This leaves the millennials with a problem. How can they cope with a situation where they don't have anyone representing their interests either in Congress where it's really the same party now, or with an opportunity to earn enough to get a home mortgage? It's very hard to earn the money that you need to buy a house anymore. There has to be a god in a machine – *Deus Ex Machina* – meaning rich parents or a rich uncle.

Paul Sliker: So maybe a better investment for millennials would be to organize outside the banks.

Michael Hudson: Well, here's the other problem: Congress last week deregulated community banks. I've worked as a consultant for community banks in Chicago. Their strategy is to make more reckless loans than the commercial banks. So deregulating them enables them to lend at even higher debt to equity ratios. They can set lower down payments, and help bid up the price of real estate even more. So the congressional rewriting of bank regulations last week makes it much harder for millennials to get an apartment, because it will inflate the price of housing with yet more bank credit.

Paul Sliker: Fascinating. Well Michael, like every week, I wish we had more time to talk. But I did want to let everyone know who is in the Greater New York area that this coming Saturday, June 2nd, 2pm at The Left Forum in Manhattan at John Jay College, I'll be moderating a panel—Negative Economics – its Pedigree and History—between Michael Hudson and Michael Perelman about the long pedigree of anti-labor and anti-reform junk economics from the 18th-century classical economists to the Austrians and modern mainstream. You can find more info about that, on LeftForum.org

But Michael Hudson, thanks again for joining us on this week's edition of Left Out's "The Hudson Report."

Michael Hudson: It's good to be here with you ,and I'm glad we had a chance to talk about real estate for a change.