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Wall Street Has Taken Over the Economy and is Draining It

By Michael Hudson – Gordon Long
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GORDON LONG: Thank you for joining us. I'm Gordon Long with the Financial Repression Authority. It's my pleasure to have with me today Dr. Michael Hudson Professor Hudson's very well known in terms of the FIRE economy to—I think, to a lot of our listeners, or at least he's recognized by many as fostering that concept. A well-known author, he has published many, many books, including most recently Killing the Host. Welcome, Professor Hudson.

MICHAEL HUDSON: Yes.

LONG: Let's just jump into the subject. I mentioned the FIRE economy cause I know that I have always heard it coming from yourself—or, indirectly, not directly, from yourself. Could you explain to our listeners what's meant by that terminology?

HUDSON: Well it's more than just people getting fired. FIRE is an acronym for Finance, Insurance and Real Estate. Basically that sector is about assets, not production and consumption. And most people think of the economy as being producers making goods and services and paying labor to produce them – and then, labour is going to buy these goods and services. But this production and consumption economy is surrounded by the asset economy: the web of Finance, Insurance, and Real Estate of who owns assets, and who owes the debts, and to whom.

LONG: How would you differentiate it (or would you) with what's often referred to as financialization, or the financialization of our economy? Are they one and the same?

HUDSON: Pretty much. The Finance, Insurance, and Real Estate sector is dominated by finance. 70 to 80% of bank loans in North America and Europe are mortgage loans against real estate. So instead of a landowner class owning property clean and clear, as they did in the 19th century, now you have a democratization of real estate. 2/3 or more of the population owns their own home. But the only way to buy a home, or commercial real estate, is on credit. So the loan-to-value ratio goes up steadily. Banks lend more and more money to the real estate sector. A home or piece of real estate, or a stock or bond, is worth whatever banks are willing to lend against it.

As banks loosen their credit terms, as they lower their interest rates, take lower down payments, and lower amortization rates – by making interest-only loans – they are going to lend more and more against property. So real estate is bid up on credit. All this rise in price is debt leverage. So a financialized economy is a debt-leveraged economy, whether it's real estate or insurance, or buying an education, or just living. And debt leveraging means that a larger proportion of assets are represented by debt. So debt equity ratios rise. But financialization also means that more and more of people's income and corporate and government tax revenue is paid to creditors. There's a flow of revenue from the production-and-consumption economy to the financial sector.

LONG: I don't know if you know Richard Duncan. He was with the IMF, etc, and lives in Thailand. He argues right now that capitalism is no longer functioning, and really what he refers to what we have now is "creditism." Because in capitalism we have savings that are reinvested into productive assets that create productivity, which leads to a higher level of living. We're not doing that. We have no savings and investments. Credit is high in the financial sector, but it's not being applied to productive assets. Is he valid in that thinking?

HUDSON: Not as in your statement. It's confused. What I object to is the characterization of today's situation as "financialization." I explained that financialization is the FIRST stage — when finance WORKS. We are now in the BREAKDOWN of financialization — toward the "barter" stage. Treating "finance" as an end stage rather than as a beginning stage overlooks the dynamics of breakdown. It is debt deflation. First profits fall, and as that occurs, rents on commercial property decline. This is already widespread here in New York, from Manhattan (8th St. near NYU is half empty) to Queens (Austin St. in Forest Hills.).

LONG: Okay.

HUDSON: There's an enormous amount of savings. Gross savings. The savings we have that are mounting up are just about as large as they've ever been – about, 18-19% of the US economy.

They're counterpart is debt. Most savings are lent out to borrowers se debt. Basically, you have savers at the top of the pyramid, the 1% lending out their savings to the 99%. The overall net savings may be zero, and that's what your stupid person from the IMF meant. But gross savings are much higher. Now, the person, Mr. Duncan, obviously—I don't know what to say when I hear this nonsense. Every economy is a credit economy.

Let's start in Ancient Mesopotamia. The group that I organized out of Harvard has done a 20-study of the origins of economic structuring in the Bronze Age, even the Neolithic, and the Bronze Age economy – 3200 BC going back to about 1200 BC. Suppose you're a Babylonian in the time of Hammurabi, about 1750 BC, and you're a cultivator. How do you buy things during the year? Well, if you go to the bar, to an ale woman, what she'd do is write down the debt that you owe. It was to be paid on the threshing floor. The debts were basically paid basically once a year when the income was there, on the threshing floor when the harvest was in. If the palace or the temples would advance animals or inputs or other public services, this would be as a debt. It was all paid in grain, which was monetized for paying debts to the palace, temples and other creditors.

The IMF has this Austrian theory that pretends that money began as barter and that capitalism basically operates on barter. This always is a disinformation campaign. Nobody believed this in times past, and it is a very modern theory that basically is used to say, "Oh, debt is bad." What they really mean is that public debt is bad. The government shouldn't create money, the government shouldn't run budget deficits but should leave the economy to rely on the banks. So the banks should run and indebt the economy.

You're dealing with a public relations mythology that's used as a means of deception for most people. You can usually ignore just about everything the IMF says. If you understand money you're not going to be hired by the IMF. The precondition for being hired by the IMF is *not* to understand finance. If you do understand finance, you're fired and blacklisted. That's why they impose austerity programs that they call "stabilization programs" that actually are destabilization programs almost wherever they're imposed.

LONG: Is this a lack of understanding and adherence to the wrong philosophy, or how did we get into this trap?

HUDSON: We have an actively erroneous view, not just a lack of understanding. This is not by accident. When you have an error repeated year after year after year, decade after decade after decade, it's not really insanity doing the same thing thinking it'll be different. It's sanity. It's doing the same thing thinking the result *will* be the same again and again and again. The result will indeed be austerity programs, making budget deficits even worse, driving governments further into debt, further into reliance on the IMF. So then the IMF turns them to the knuckle breakers of the World Bank and says, "Oh, now you have to pay your debts by privatization". It's the success. The successful error of monetarism is to force countries to have such self-defeating policies that they end up having to privatize their natural resources, their public domain, their public enterprises, their communications and transportation, like you're seeing in Greece's selloffs. So when you find an error that is repeated, it's deliberate. It's not insane. It's part of the program, not a bug.

LONG: Where does this lead us? What's the roadmap ahead of us here?

HUDSON: A thousand years ago, if you were a marauding gang and you wanted to take over a country's land and its natural resources and public sector, you'd have to invade it with military troops. Now you use finance to take over countries. So it leads us into a realm where everything that the classical economists saw and argued for – public investment, bringing costs in line with the actual cost of production – that's all rejected in favor of a *rentier* class evolving into an oligarchy. Basically, financiers – the 1% – are going to pry away the public domain from the government. Pry away and privatize the public enterprises, land, natural resources, so that bondholders and privatizers get all of the revenue for themselves. It's all sucked up to the top of the pyramid, impoverishing the 99%.

LONG: Well I think most people, without understanding economics, would instinctively tell you they think that's what's happening right now, in some way.

HUDSON: Right. As long as you can avoid studying economics you know what's happened. Once you take an economics course you step into brainwashing. It's an Orwellian world.

LONG: I think you said it perfectly well there. Exactly. It gets you locked into the wrong way of thinking as opposed to just basic common sense. Your book is Killing the Host. What was the essence of its message? Was it describing exactly what we're talking about here?

HUDSON: Finance has taken over the industrial economy, so that instead of finance becoming what it was expected to be in the 19th century, instead of the banks evolving from usurious organizations that leant to governments, mainly to wage war, finance was going to be industrialized. They were going to mobilize savings and recycle it to finance the means of production, starting with heavy industry. This was actually happening in Germany in the late 19th century. You had the big banks working with government and industry in a triangular process. But that's not what's happening now. After WW1 and especially after WW2, finance reverted to its pre-industrial form. Instead of allying themselves with industry, as banks were expected to do, banks allied themselves with real estate and monopolies, realizing that they can make more money off real estate.

The bank spokesman David Ricardo argued against the landed interest in 1817, against land rent. Now the banks are all in favor of supporting land rent, knowing that today, when people buy and sell property, they need credit and pay interest for it. The banks are going to get all the rent. So you have the banks merge with real estate against industry, against the economy as a whole. The result is that they're part of the overhead process, not part of the production process.

LONG: There's a sense that there's a crisis lying ahead in the next year, two years, or three years. The mainstream economy's so disconnected from Wall Street economy. What's your view on that?

HUDSON: It's not disconnected at all. The Wall Street economy has taken over the economy and is draining it. Under what economics students are taught as Say's Law, the economy's workers are supposed to use their income to buy what they produce. That's why Henry Ford paid them $5 a day, so that they could afford to buy the automobiles they were producing.

LONG: Exactly.

HUDSON: But Wall Street is interjecting itself into the economy, so that instead of the circular flow between producers and consumers, you have more and more of the flow diverted to pay interest, insurance and rent. In other words, to pay the FIRE sector. It all ends up with the financial sector, most of which is owned by the 1%. So, their way of formulating it is to distract attention from today's debt quandary by saying it's just a cycle, or it's "secular stagnation." That removes the element of agency – active politicking by the financial interests and Wall Street lobbyists to obtain all the growth of income and wealth for themselves. That's what happened in America and Canada since the late 1970s.

LONG: What does an investor do today, or somebody who's looking for retirement, trying to save for the future, and they see some of these things occurring. What should they be thinking about? Or how should they be protecting themselves?

HUDSON: What all the billionaires and the heavy investors do is simply try to preserve their wealth. They're not trying to make money, they're not trying to speculate. If you're an investor, you're not going to outsmart Wall Street billionaires, because the markets are basically fixed. It's the George Soros principle. If you have so much money, billions of dollars, you can break the Bank of England. You don't follow the market, you don't anticipate it, you actually make the market and push it up, like the Plunge Protection Team is doing with the stock market these days. You have to be able to control the prices. Insiders make money, but small investors are not going to make money.

Since you're in Canada, I remember the beginning of the 1960s. I used to look at the *Treasury Bulletin* and *Federal Reserve Bulletin* figures on foreign investment in the US stock market. We all used to laugh at Canada especially. The Canadians don't buy stocks until they're up to the very top, and then they lose all the money by holding these stocks on the downturn. Finally, when the market's all the way at the bottom, Canadians decide to begin selling because they finally can see a trend. So they miss the upswing until they decide to buy at the top once again. It's hilarious to look at how Canada has performed in the US bond market, and they did the same in the silver market. I remember when silver was going up to $50. The Canadians said, "Yes, we can see the trend now!" and they began to buy it. They lost their shirts. So, basically, if you're a Canadian investor, move.

LONG: So the Canadian investors are a better contrarian indicator than the front page cover, you're saying.

HUDSON: I'd think so. Once they get in, you know the bubble's over.

LONG: Absolutely on that one. What are you currently writing? What is your current focus now?

HUDSON: Well, I just finished a book. You mentioned *Killing the Host*. My next book will be out in about three months: *J is for Junk Economics*. It began as a dictionary of terms, so I can provide people with a vocabulary. As we got in the argument at the beginning of your program today, our argument is about the vocabulary we're using and the words you're using. The vocabulary taught to students today in economics – and used by the mass media and by government spokesmen – is basically a set of euphemisms. If you look at the television reports on the market, they say that any loss in the stock market isn't a loss, it's "profit taking". And when they talk about money. the stock market rises – "Oh that's good news." But it's awful news for the short sellers it wipes out. Almost all the words we get are kind of euphemisms to conceal the actual dynamics that are happening. For instance, "secular stagnation" means it's all a cycle. Even the idea of "business cycles": Nobody in the 19th century used the word "business cycle". They spoke about "crashes". They knew that things go up slowly and then they plunge very quickly. It was a crash. It's not the sine curve that you have in Josef Schumpeter's book on *Business Cycles*. It's a ratchet effect: slow up, quick down. A cycle is something that is automatic, and if it's a cycle and you have leading and lagging indicators as the National Bureau of Economic Research has. Then you'd think "Oh, okay, everything that goes up will come down, and everything that goes down will come up, just wait your turn." And that means governments should be passive.

Well, that is the opposite of everything that's said in classical economics and the Progressive Era, when they realized that economies don't recover by themselves. You need a—the government to step in, you need something "exogenous," as economist say. You need something from outside the system to revive it. The covert idea of this business cycle analysis is to leave out the role of government. If you look at neoliberal and Austrian theory, there's no role for government spending, and no role of public investment. The whole argument for privatization, for instance, is the opposite of what was taught in American business schools in the 19th century. The first professor of economics at the Wharton School of Business, which was the first business school, was Simon Patten. He said that public infrastructure is a fourth factor of production. But its role isn't to make a profit. It's to lower the cost of public services and basic inputs to lower the cost of living and lower the cost of doing business to make the economy more competitive. But privatization adds interest payments, dividends, managerial payments, stock buybacks, and merges and acquisitions. Obviously these financialized charges are factored into the price system and raise the cost of living and doing business.

LONG: Well, Michael, we're—I thank you for the time, and we're up against our hard line. I know we didn't have as much time as we always like, so we have to break. Any overall comments you'd like to leave with our listeners who might be interested this school of economics?

HUDSON: Regarding the downturn we're in, we're going into a debt deflation. The key of understanding the economy is to look at debt. The economy has to spend more and more money on debt service. The reason the economy is not recovering isn't simply because this is a normal cycle. And It's not because labour is paid too much. It's because people are diverting more and more of their income to paying their debts, so they can't afford to buy goods. Markets are shrinking – and if markets are shrinking, then real estate rents are shrinking, profits are shrinking. Instead of using their earnings to reinvest and hire more labour to increase production, companies are using their earnings for stock buybacks and dividend payouts to raise the share price so that the managers can take their revenue in the form of bonuses and stocks and live in the short run. They're leaving their companies as bankrupt shells, which is pretty much what hedge funds do when they take over companies.

So the financialization of companies is the reverse of everything Adam Smith, John Stuart Mill, and everyone you think of as a classical economist was saying. Banks wrap themselves in a cloak of classical economics by dropping history of economic thought from the curriculum, which is pretty much what's happened. And Canada—I know since you're from Canada, my experience there was that the banks have a huge lobbying power over government. In 1979, I wrote for the IRPP Institute there on *Canada In the New Monetary Order*. At that time the provinces of Canada were borrowing money from Switzerland and Germany because they could borrow it at much lower interest rates. I said that this was going to be a disaster, and one that was completely unnecessary. If Canadian provinces borrow in Francs or any other foreign currency, this money goes into the central bank, which then creates Canadian dollars to spend. Why not have the central bank simply create these dollars *without* having Swiss francs, without having German marks? It's unnecessary to have an intermediary. But the more thuggish banks, like the Bank of Nova Scotia, said, "Oh, that way's the road to serfdom." It's not. Following the banks and the Austrian School of the banks' philosophy, *that's* the road to serfdom. *That's* the road to debt serfdom. It should not be taken now. It lets universities and the government be run by neoliberals. They're a travesty of what real economics is all about.