

landed aristocracy pressured the government to stop estimating land value. The timeless guiding principle is that if the tax collector doesn't see the land's rental value, there is less chance of it being taxed. So land – which used to be deemed “visible wealth” (in contrast to finance as “invisibles”) became statistically invisible, not only to the tax collector but to government policy makers and the economics profession.

Wall Street raiders, to be sure, spend much of their time poring over corporate balance sheets looking for undervalued land, hoping to buy out companies based on current earnings projections rather than the “breakup price” of selling their land at a capital gain. Academic and public sector economics thus lags behind pragmatic wealth seeking by ambitious Wall Street leaders and their investment bankers.

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It was the invading Normans, after all, who ordered compilation of the Domesday Book in 1200 to extract rent as, in effect, military tribute from a defeated land. It always is the absentee owner, outside buyer or their creditors who have the major interest in calculating the return to land, not the occupants and users themselves.

About ten years ago the mayor of London, Ken Livingston, sent his economist Alan Freeman over to the United States for an Eastern Economic Association meeting in Boston. I introduced him to my colleague Ted Gwartney, the property assessor for Bridgeport, Connecticut. Ted explained that his job was to draw up a land map of the city's properties. His methodology in making this map was so simple and straightforward that he won every court case brought against the city by property owners who protested that his assessments were too high.

The British economist asked how long it took him to make such a map. Ted said that he had two assistants, and it took three months. The economist looked wide-eyed and said: “This is incredible. You should win the Nobel Prize for this! Are you the only person in the world who does this? I've never heard of such efficiency.”

Ted laughed and told him that there are thirty thousand assessors in the United States that do just what he does. They do it for every city and county in the nation every two or three years. The Englishman was amazed, and we discussed whether London might sponsor a similar study.

The proposal never came to fruition, largely as a result of lobbying by property interests. Real estate investors certainly want to know what they are buying and selling, but want outsiders to know as little as possible. They worry that if the government measures land value – especially the appreciation of land prices – political pressure will arise to tax it.

The upshot is that governments measure wages and corporate profits, but have only the roughest estimate of wealth, its distribution and rate of growth. Only Japanese statistics have good measures of land prices. No national income statistics today measure the most important asset on which classical economics focused: unearned income and unearned wealth.

This is the concept most seriously lacking from post-classical economics: recognition of the fact that someone can earn an income without producing a service of equal social value. Matters almost have got to the point where if someone robs you in front of a bank teller or ATM and says “Your money or your life,” the national income and product accounts would depict this as a life-saving service, not as a zero-sum transfer payment. The NIPA incorporate this kind of circular reasoning. Newspapers and television report gross domestic product as if it were actual product, not simply “gross domestic cost.”

Rather than measuring economic well being, GDP includes a widening FIRE sector overhead wedge that is a purely extractive zero-sum activity, not a productive one.



The idea of unearned revenue that has no counterpart in the actual cost of production has become anathema, and with it the idea of economic rent as a product of legal privilege to extract income without having to produce a corresponding real service. Yet this is what occurs when financial CEOs give themselves tens of millions of dollars of salary and bonuses. This revenue has no necessary cost of production. If it wasn't necessary twenty years ago or ten years ago, it is not necessary now. But it is counted as adding to GDP in payment for producing a "financial service," just as the U.S. Congress has a Financial Services Committee without recognizing that this term is itself an oxymoron.

I find it remarkable that nobody has pointed out that Adam Smith did not say what neoliberals repeat when they count him as their patron saint. His aim, like that of subsequent classical reformers, was to free society from privatized land rent, monopoly rents, and financial interest and fees. These revenues come from purely property rights and privilege, not from basic technological or economic necessity. It was to isolate these forms of overhead that classical economists developed their analysis and quantified it in the 18<sup>th</sup> and 19<sup>th</sup> centuries.

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Inevitably, the *rentiers* fought back. They naturally preferred a post-classical economics that was careful to avoid looking at what is really important in life, especially at how wealth was being obtained. Wealthy people like to think of themselves as earning income, not extracting it or getting a free ride. They even like to think of themselves as hosts, not as parasites – it is the poor, the welfare recipients and even their employees who are the parasites whose income is to be minimized, not their own privileged rake-off income, which they demand should receive special tax benefits because the wealthy financial classes are so essential for economic survival.

The symbiosis between predatory finance and land ownership is an old problem – one that buried the Roman economy two thousand years ago. Individuals who managed to gain wealth bought landed estates, seeking the prestige of joining the gentry rather than pursuing enterprise, which was disparaged as ungentlemanly. And wealthy landowners accu-

mulated clients and had their slaves or sleeping partners lend out their money at usury.<sup>6</sup> Yet modern discussion over what caused the decline and fall of Rome no longer points to the debt crisis described in great melodramatic detail by its own historians Livy, Plutarch and Diodorus. Just as debt problems have been excluded from the economics curriculum, they have become buried in the narrative of Western civilization's social history.

The reason is not hard to understand. A realistic economic theory would describe the problems caused by the tendency of debts to grow faster than the means to pay. Recognizing the phenomenon of debt deflation would lead to political pressure to stop the process and save the economy by writing down debts to the ability to pay. This would prevent the asset stripping and concentration of power in the hands of a financial class. Although this would save the economy – and indeed, enable it to continue to grow – it is not what the financial class desires. Its aim is to check any public power threatening to save the economy from indebtedness.

Prior to Roman antiquity, starting in the Bronze Age Near East where nearly all of civilization's financial practices began, the major creditors were the public temples and palaces, not a private oligarchy. It was easy for rulers to cancel debts when most were owed to themselves or their royal collectors. But by classical antiquity, the oligarchy overthrew kings and their practice of preserving widespread liberty by debt relief. But that is another story ...

### **The post-classical road to neo-feudalism and debt peonage: Latvia's disastrous "Baltic miracle"**

The banker's-eye view of the world has a blind spot, which is reflected in today's political economy. Probably the most seriously affected victims are the former Soviet States. When the old Soviet Union was dissolved in 1991, Russia, the Baltics and other East Bloc economies agreed to adopt an identical predatory Western financial program. Neoliberals were sent from various U.S. universities – the Harvard Boys to Russia, Washington University boys to Latvia, and so forth. In every case a voucher program pretended to give workers ownership of all the industry and public enterprises. This was called "peoples' capitalism" – an Orwellian Doublethink term that Margaret Thatcher had coined for Gen. Pinochet's Chile, which became the dress rehearsal in 1974 for the post-Soviet states after 1991 (and Iceland after 2001).

At the time the former obtained their political independence from Russia, these economies had no debt at all, no property claims for rent or interest. Yet over the past decade they have become the world's most debt-ridden countries, borrowing against real estate, public enterprises, natural mo-

<sup>6</sup> I describe this in "Entrepreneurs: From the Near Eastern Takeoff to the Roman Collapse," in David S. Landes, Joel Mokyr, and William J. Baumol, eds., *The Invention of Enterprise: Entrepreneurship from Ancient Mesopotamia to Modern Times* (Princeton: Princeton University Press, 2010):8-39.

nopolies and mineral deposits. This bank lending has enabled buyers to bid up prices for these assets, prompting the World Bank to applaud the “Baltic Miracle” in Latvia, Estonia and Lithuania. Insiders and other appropriators got rich by selling off what the former Soviet Union had put in place – and Western bankers and investors have collected much more. The West got the credit for the debt-leveraged run-up – and “old Soviet” mentality was blamed for the crash.

The West showed itself so negligent – and indeed willfully blind when it came to refusing to see how its own narrow self-interest was predatory with regard to its post-Soviet victims – that the disaster it created must be deemed deliberate, the final blow of the Cold War. The West subdued the post-Soviet population and appropriated the economic surplus from the property it had built up, along almost identical lines that had occurred in Latin America in the 16<sup>th</sup> and 17<sup>th</sup> centuries, and Africa in the 19<sup>th</sup> century, replete with client chieftains, tax “freedom” for the predators and, in due course, debt peonage for the local labor force.

The post-Soviet trade problem was clear enough at the outset. The USSR had been a far-flung economic unit, dispersing most industrial production throughout its member states. These linkages were uprooted when the post-Soviet states emerged from Russian domination. Breakup of intra-Soviet trade left these economies dependent on Western imports for consumer and capital goods, food and many other essentials.

To pay for this trade dependency they needed credit. They hoped that their commitment to join the European Union would be reciprocated by something like Marshall Plan aid, and above all with advice to help them develop along the path that Europe had taken. This expectation turned out to be drastically wrong. Europe misrepresented its history in so blatantly dishonest a way that one can only regret the lack of an international law against destroying a population by imposing an economic ideology with almost religious intolerance (not exactly a novel crime for Europeans to have imposed on the world).

Most European countries had developed by tariff protection, headed by the Common Agricultural Policy subsidizing enormous dairy and crop surpluses for export. Europe also had nurtured its manufacturing and a middle class by public subsidy and infrastructure support, anti-monopoly regulations and progressive taxation of income and wealth. However, the last thing that European governments wanted was to nurture the Baltics and Central Europe as rivals.

“Old Europe” saw them crassly as prospective markets for agricultural surpluses and other exports, and as financial colonies and markets for bank loans. Austrian banks, for instance, made hard-currency loans to the nation’s historic Hungarian market, and Swedish banks set up Baltic affiliates to lend euros as well as Swiss francs and sterling to buy the real estate and other assets being privatized from the public domain from an initially debt-free position. Local populations throughout the post-Soviet bloc borrowed to buy the homes

occupied without formal ownership rights under Soviet rule. Political insiders developed hotels and the Old Town areas of major cities as tourist centers.

By 2004 a property bubble was well underway, as it was in the West. Housing and office prices soared toward equality with European capital cities. This fueled a real estate bubble that seemed to be a banker’s dream because its low starting point triggered a wave of sales and re-sales. Nearly all this mortgage lending was denominated in foreign currency against the real estate and other public assets being privatized. Some 90 percent of Latvian mortgages are denominated in Euros or foreign currency.

It was this borrowing from foreign banks that provided the post-Soviet economies with the foreign exchange to pay for their trade deficits. This was the great trade-off – increasing debt for current imports. It was bound to come to an end at the point where all the real estate was fully “loaned up.” And this point arrived when the global real estate bubble burst in 2008. Since then, mortgage lending to these countries has dried up – and housing prices have plunged between 50 and 70 percent in Latvia (and also in Iceland, discussed below).



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Yet their trade deficits persist. The post-Soviet economies still need to import consumer goods, fuel and food, machinery and other essentials. But Europe had done little to help them put in place export industries to cover the cost of these imports. These countries simply ran up mortgage debts against their real estate and other assets inherited from Soviet times. So the only alternative to default on foreign-currency loans has been to take out yet new loans – to borrow the interest due. And this time around, the borrowing is being done by the post-Soviet governments and their central banks, not by the private sector. This means that not only are the new debts owed to foreign governments rather than to commercial banks, but that the terms are much more onerous, destructive and, in a word, neo-colonialist.

Inter-governmental loans are problematic, because they are explicitly nationalistic on the part of creditor na-

tions – and correspondingly injurious to the debtor country. They sacrifice policy-making autonomy to the International Monetary Fund and, in the post-Soviet case, to the European Union bureaucracy. The EU and IMF basically use debtor countries as vehicles to extend credit to their own banks and exporters. Over the past two years they have “helped” the post-Soviet countries maintain their exchange rates by sacrificing their domestic economies. The aim of this policy is to sustain the payment of mortgages to European banks that otherwise would have to take heavy losses on their loans to real estate debtors unable to pay the higher carrying charge that would result from their domestic-currency revenue falling against the euro.



Robbert\_van\_der\_Steeg

The EU has made it clear that its credit is not to finance domestic investment or spending, but just the opposite. It requires debtor governments to impose austerity and even run budget surpluses to squeeze out foreign exchange by limiting the population's ability to afford imports and presumably “free” output for export. (It never works.) This policy of economic shrinkage is just the opposite of Keynesian counter-cyclical spending such as Mr. Obama's Stimulus plan to help pull the United States out of its own downturn. Austerity plans are only for export to economic dependencies – and make them even more dependent on the financial core.<sup>7</sup>

Latvia's GDP fell by 18 percent in 2009, and is forecast to shrink altogether by nearly 30 percent from the crisis' onset in autumn 2008 until the end. More people already are out of work (the year end 2009 unemployment rate is reported to be 16.8 percent), so default rates are rising. Housing and other real estate prices have plunged by about 50 to 70 percent in most markets, and new construction has all but stopped.

In the public sector where shrinkage is most drastic, Latvia had over 150 hospitals and clinics when the Soviet period ended in 1991. By 2009 it had only around 40, and the IMF and World Bank demanded that it close half of them. Many needed services were closed, including trauma centers and ambulance services. Public health standards have worsened and life spans shortened by several years for men, as has been the case in Russia. There has been an exodus of doctors and health specialists, especially to the richer neighboring Scandinavian countries – part of a serious emigration of highly skilled and unskilled workers alike. According to a recent poll, about a quarter of the male population aged between 20 and 35 years old plans to emigrate during the next five years. And as for the training of new professionals, formerly free universities are now charging tuition, so money rather than talent now obtains higher education. This is the result of financialization as Latvia shrinks its economy to pay foreign creditors.

One motive spurring emigration is to avoid being reduced to a lifetime of debt peonage. Homeowners find themselves frozen into their homes almost as serfs as property prices plunge below the amount of their mortgage debt. They cannot move out, because they would have to pay banks the balance due on their negative equity. They, not the banks, must absorb the loss on the bad loan. Unable to find a buyer at a price that covers their mortgage, debtors remain personally liable to save the Swedish bankers from taking a loss, by making up the difference out of their own future earnings. And the situation is getting worse as rents fall in the shrinking economy. There is no way to find renters to cover the mortgage debt. Many debtors are deciding that it is easier to leave the country. This is what many parents are urging their children to do today.

So the economy seems to be in a death spiral – not only economic death but a demographic crisis as well. Matters threaten to worsen if Latvia's trade deficit forces the currency to be devalued. Carrying charges on the 87 percent of Latvian mortgages denominated in foreign currency would soar. But the only way to stave off devaluation is to keep on borrowing from the EU and IMF. Worse yet, the financial dictates of the Washington Consensus call for rolling back

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<sup>7</sup> I provide a history of theorizing along these lines – and of alternatives – in *Trade, Development and Foreign Debt* (1992; new ed. ISLET 2009).

wages and living standards, taxing labor all the more and slashing public spending and investment even further! Instead of coming up with a plan to extricate the economy from this debt peonage, Latvia's neoliberal government can only repeat its faith in "restoring equilibrium" by tightening the fiscal and financial screws.

## Iceland's cruel neoliberal experiment threatens neo-feudal financial colonialism

Much the same has occurred in Iceland under neoliberal advice to shift planning into the hands of a narrow banking and financial class. In 2001, a decade after the post-Soviet states separated from Russia, Iceland gave away its commanding heights to political insiders and privatized the country's three leading banks in an atmosphere of deregulation, with the usual insider corruption. Foreign loans and deposits flowed in, and were lent out to bid up housing prices – while providing the central bank with enough foreign exchange to sustain a splurge on imports. In just seven years Iceland rose from a fishing and farming backwater to become one of the stars of world financial and real estate markets, before blowing in a convulsion of debt-ridden bankruptcy.

Icelanders imagined themselves getting rich during the first few years of this process. As recently as 2007 the United Nations ranked their country as the world's happiest. But its plunging currency has led property prices to fall by 70 percent since its financial system went bankrupt in October 2008. Having given away its banks, the government is being held liable for the debts that they ran up to British and Dutch depositors in Icesave's on-line bank accounts. But tax revenues are plunging as the economy shrinks, leaving the government broke.

The population is in the same state. Mortgages are indexed to consumer prices, which are set by import prices. The effect is to denominate Icelandic mortgages in euros, while income is earned in soft domestic krónur in a shrinking economy. As in Latvia, denominating debts in euros or sterling protects creditor interests, but has turned Iceland into a debtor's hell. Mortgages at interest rates from about 5 to 5-6% are indexed to the rate of price increases, which means in effect to the foreign exchange rate. This imposed an 18% financial tax charge on Icelanders by spring of 2008. On balance, homeowners had to pay over 23% mortgage interest (18% + 5%) on property that had fallen so far as to be unsalable. Homeowners remain personally liable if they move, as in Europe.

Bankruptcy rates are rising, and so is the suicide rate. Labor is emigrating, and foreign labor already has left. As many as a third of the Icelandic young adults are reported to be planning to emigrate to escape mortgage debt and the collapse of employment. So much for being a happy debt-financed economy! Its legacy is debt peonage, the final stage of neoliberalism.

Iceland held parliamentary elections in April 2008.

I met earlier with a number of Icelandic political leaders and former Prime Ministers to discuss how the currency faced further depreciation as a result of the debt overhang and chronic trade deficit. They worried that it would upset most voters to bring up so intractable a problem before the elections. The usual tendency in democracies these days is to vote for politicians who promise the best future. So the election proceeded without serious economic discussion. The Social Democrat-Green coalition won, with a prime minister who promised to take the country into Europe.

At that time about two-thirds of the voters still thought that Europe wanted to help them. (This was the same hope that the post-Soviet states earlier had held.) By early 2010 only about 40 percent want to join Europe, and the government faced a no-confidence vote by a number of parties over what to do about the debts that Britain and the Netherlands are claiming to be owed. In summer 2009 in Parliament, Gordon Brown was asked about depositors who had lost money in Kaupthing, a British bank owned by Icelandic investors. As a domestic affiliate, it came under Britain's public regulatory authority. Gordon Brown said in Parliament that he intended to lean on the IMF to refuse to lend any money to Iceland, and indeed to block its attempt to join the EU if it didn't pay what he was demanding – full reimbursement plus punitive interest charges!



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By contrast, IceSave was organized as a *branch* of Landsbanki, and hence fell under Iceland's own domestic, purely private insurance scheme. Its computerized internet accounts offered a very high rate of return – higher than normally were available, reflecting the risk of losing money to a banking system whose national bank insurance had been thoroughly privatized and neoliberalized with little regard for risk, and with scant oversight of the kleptocratic insiders using deposits to gamble in the world's financial casinos. Yet I'm told that local council authorities in England were directed to deposit their money in Icesave because they had a "fiduciary responsibility" to put their savings where they could get the highest interest rate.

"Blame the foreigner" is always a winning political ploy. In demanding compensation in the face of their own regulatory failure, the British and Dutch acted without

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regard for the law. Like most lawbreakers, they have refused to submit the issue to third-party arbitration. What is being brought to bear is the exercise of pure creditor power – the power to destroy an economy, depopulate it and starve it of essentials in what is the equivalent of a military blockade. As in war, the effect is a loss of life. Icelandic suicide rates are rising, emigration is rising, and life spans are shortening, just as in the Baltics and other debt-strapped economies. This is financial neo-feudalism!

European Union rules give a three-month breathing time for any bank that goes bankrupt to withhold settlement from depositors, and two more three-month extensions. So under EU law the Icelandic banks had nine months to settle. But to save face in the wake of the Northern Rock bank collapse in Britain, Gordon Brown moved in just two days to repay all the depositors, using anti-terrorist laws against Iceland. Branding it as a terrorist nation was the quickest way to freeze and take over Icelandic assets. The absurdity of this is that Iceland has no army. It is hard to imagine any accusation that could have made them more resentful.



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To cap the insult, Mr. Brown's threat to lean on the IMF to act as a debt collector was illegal, because Iceland technically didn't owe the money. To hold its government responsible, the British and Dutch took a hard line with Icelandic negotiators, who capitulated and returned to Iceland with a bad deal calling for Iceland to pay 4% of its GDP growth over and above 2007 levels to settle with European Icesave depositors over a period of seven years. From 2010, there would be a seven-year waiting period, and from 2017-2024, Iceland is pay the balance due.

The governing coalition supported the plan, but a political scandal over the terms led it to add the condition

that after 2024 Iceland would re-examine the remaining debt, and no further payments will be made if it is deemed that this would cause extreme distress. This would be logical, especially in view of the fact that according to the letter of EU law, Iceland can argue that it owes nothing to either the British or Dutch governments.

But in a show of hubris Mr. Brown and the Dutch rejected this condition. They continued to threaten not to let Iceland join Europe unless the government agrees to pay them in full for the mistake that their own bank insurance agencies made in jumping the gun. Iceland's Althing duly knuckled under, but Iceland's President refused to sign the deal, and insisted that such an important agreement – one that would destroy the national economy for a generation and drive perhaps a third of the population out of the country, reducing the land to neo-feudal status – should be put to a vote, which was scheduled for March 5, 2010.

Public opinion polls showed some 70 percent of the population oppose the agreement – and have soured on the very prospect of joining the EU, seeing it as an exploitative financial power rather than the Social Democratic union they earlier had imagined it to be. The actual election showed less than 2% of Icelanders voting in favor of the agreement. (Some 93% voted against it, and another 5% turned in blank ballots in what was characterized as a silent protest.)

The nation is being treated as a financial colony, not as an equal. Matters got so bad by February 22, 2010, that Iceland's prime minister felt driven to beg U.S. Secretary of State Hillary Clinton to help ensure that the Icesave dispute would not be permitted to threaten completion of the IMF loan that was keeping the currency above the level where mortgage debtors would owe yet higher indexed debt service each month.

## **An alternative economic program to that of the neoliberal Washington Consensus**

Like many other post-Soviet economies, Latvia is a combination of the native population and Russians whom Stalin moved in during the 1950's, when he deported the middle class and others with professional backgrounds. Some 38 percent of Latvia's population are Russian speakers, and they form the major support for the Harmony Center ("Concord") Party. Joined last year by ethnic Latvians frustrated with poor governance, it became the ruling party of Riga, the capital city. National elections will occur in October 2010. I head a Committee of Experts charged with drawing up an economic platform to rescue the country from the neoliberalism to which it has been subjected since it achieved political independence from Russia in 1991.

Our first recommendation is that in view of the fact that the currency is under pressure to be devalued – with 87 percent of mortgage debts being denominated in foreign currency – banks should only be able to take the house itself when they foreclose. This is the collateral that was supposed to back the loan, after all. It is what makes mortgage loans



should be no more personal liability for mortgage debt. The Swedish finance minister became furious and said that this would break all tradition. The Harmony Centre (“Concord”) Party replied that the tradition to which Sweden seemed to be referring was feudalism, and reminded Sweden that Latvia threw off the Swedish yoke back in the 15<sup>th</sup> century – and threw out the German land barons in 1905.

I have seen no discussion of this in the press, except for my own write-ups in the *Financial Times*. There is a case of cognitive dissonance when it comes to structural financial and fiscal reform. Most people are not aware that a workable alternative exists, one that was viewed for a century as being the free market alternative – a market free of unearned income and “empty” pricing. Students no longer are taught that economic thinkers have spent the last seven centuries discussing better modes of taxation, banking and pricing, based on the ability to distinguish between economically necessary costs and income, and unnecessary costs.

different from personal loans. Banks must share responsibility for keeping loans within the debtor’s ability to pay. That basic rule has been violated throughout the world in recent years. This has been largely a result of the banks’ greed in making loans more than 70 percent of the property’s value, as was long the rule in the United States. Personal liability is not going to be permitted. I don’t know any other way to prevent banks from making irresponsible loans and then trying to blame the debtor. This is unconscionable, and we are going to prevent it from recurring.

Second, we urge that all loans and obligations should be re-denominated in domestic currency. This is similar to what U.S. President Franklin Roosevelt did in 1932 when he overruled the gold clause in most loan contracts. (The clause stated that if the price of gold changed, the debt had to be paid in gold equivalence.) This was intended to prevent creditors from obtaining a windfall gain and indeed, a gain beyond the ability of debtors to pay and hence at the expense of economic recovery. The economy comes first, not the bankers. This is especially important in today’s world, where there is no longer a constraint on the banking system’s ability to monetize credit.

A third plank of our program is designed to cope with the problem of abandoned housing, squatters and crime that has plagued foreclosures in the United States. Upon insolvency or foreclosure of residential and commercial property, the foreclosing bank must put it up for auction within one month, to be sold at a market price. The current occupant (either the indebted owner or renter) will have the right to match the bid. Our plan is for the government to set up a bank to lend the occupant funds to buy the property, converting its current rental value into mortgage debt service. At current prices, the new mortgage may be about 30 percent of the existing debt – and it will be denominated in domestic currency. The oligarchs seem happy with this, because loans on the large public utilities and other assets they have taken over and borrowed against also will be re-denominated in domestic currency.

In October 2009, Latvia’s neoliberal Prime Minister endorsed the first plank of this program, saying that there

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The classical reformers sought to complete what they viewed as the economic program of industrial capitalism: to throw off the remaining legacy of feudalism, above all the landlord aristocracy that used to be called the idle rich, and also predatory bankers – a cosmopolitan interest typically working with absentee owners, monopolists and other rent-extracting parties. Landowners, privatizers and monopolists are now backed by their international bankers, joining forces to become a new aggressive power as financial speculators. Their activities are not necessary for the industrial economy to operate, but are a *rentier* overhead that slows it down.

The most important plank of our program concerns the tax system. Like most other post-Soviet economies that

have been neoliberalized, Latvia has a dysfunctional flat tax on labor. It is so high – about 59 percent – that it is the single major factor pricing Latvian labor out of global markets. We are urging that the tax be shifted off labor and its employers onto where the classical economists urged it to be placed: on the land and natural resources.

This would “reform the reformers.” We expect that the EU and its commercial bankers will fight against this tax shift, fearing that it might spread to other countries. And of course, that is the whole point. Fiscal reform must be a key element in financial reform, because the two prongs of reform are symbiotic. Taxing the land will save its rental value from being capitalized into bank loans. Our aim is for bank credit to focus on creating new means of production, not to bolster the price of unproductive, extractive privileges and property claims.



“Stuck in Customs”

### Now that you’ve been here a week, what is your analysis of the Australian economy?

It’s hard to be an instant expert on an economy. It seems self-destructive for Australia to raise interest rates, ostensibly to slow the financial and real estate bubble. Raising interest rates will hurt public finance in three ways. Raising the rate by ¼% will oblige the government to pay more to bondholders. Homeowners with variable-rate mortgages also will have to pay more to the banks. This will leave less revenue available for spending in the domestic market. But most important is the third effect: Raising interest rates above those of other countries will enable arbitrageurs throughout the world to borrow from U.S. banks at less than 1% and lend to Australians at 3¼%, pocketing the difference. This foreign exchange inflow to buy Australian dollars will bid up the exchange rate, making imports more expensive. So higher interest rates will raise prices – just the opposite of what usually is taught in academic models.

This week I’ve read in the newspapers that manufacturing companies are lowering their profit forecasts because they realize that they can’t make export sales – or even hold onto the home market with so high an exchange rate. This is what plagued Swiss industry for many years as a result of its bank inflows from crooks, tax evaders and klepto-

crats throughout the world. Once Switzerland became a tax avoidance centre, the franc went way up. Pharmaceutical companies moved their operations across the German border to operate at a lower cost. The nation’s Manufacturing was rendered uncompetitive because of the franc’s high exchange rate. I remember that when I went there to consult for Ciba-Geigy, a Coke cost 60 cents in the United States but was \$3.50 in Basel. High living costs meant high production costs as the economy was sacrificed to Swiss banking interests.

The same thing is happening here in Australia. A friend of mine who works for the Canadian government e-mailed me today saying that Canada is going through what seems to be happening here in Australia. Because of its soaring export proceeds for raw materials, the Canadian dollar has risen sharply against the U.S. dollar. That is hurting profits for Canadian oil and gas producers, while its manufacturers are losing out to U.S. industry.

The moral is that trying to regulate the housing and financial cycle by raising interest rates penalizes the economy, by raising its cost of living and doing business. Interest is a cost of doing business, and imports become more expensive, providing an umbrella for domestic producers to raise their prices.

Yet I have heard no public discussion here of holding down real estate prices and mortgage debt by increasing the land tax. Politicians avoid this because voters react negatively to any kind of a tax rise. The distinction between efficient and inefficient taxes has been lost from public discussion. A revenue-neutral tax shift – lowering sales and income taxes on wages by the amount that property taxes are raised – would not take in any more tax revenue than now. But it would levy taxes in a way that holds down property prices. And it would leave less revenue available for banks to capitalize into interest charges. Holding down housing and real estate prices – and debt – would lower the cost of living and doing business. This would make the economy lower cost. That should be the aim of every economy – to minimize the cost of living and doing business.

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rich from seeing their home rise in price. (Actually it is not the home as such that rises, but the land site.) But this does force them further into debt to buy a home. And raising interest rates to slow the property bubble has the effect of raising the foreign exchange rate. This leads manufacturing to leave, and even erodes profits on mining, while giving the financial sector a windfall gain.

### **How can we implement your reform? How would it work from the ground up?**

The same way that classical economists advocated in the 19<sup>th</sup> century. You start by making a land map on which to base the property tax – away from buildings, onto the land. You explain to voters that this tax will leave the rental value of land unchanged, because rents are set by the “market-place.” But instead of being paid to the banks as interest as at present, this rent will be paid to the government to form the major tax base. Homeowners will pay the same amount each month – but will gain as property taxes enable the government to lower income and sales taxes by an equivalent amount. A land tax thus will lower the purchase price of property, because land rent no longer can be capitalized into a bank loan, to be converted into an interest payment to the bank. You cannot pay the same rental income twice – and what the tax collector receives is unavailable to the banker.

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You would explain that you indeed want to see capital investment in houses and other construction, and you realize that they have to make a profit on their capital expenditure. But this does not mean that they need to make a profit on the increase in price of the land’s site location – that is, what the landlord makes in his sleep. Today, real estate buyers bid against each other, and the winner is the one who pays out the rental value to the mortgage banker who creates the credit to finance the property purchase. So the financial



sector has joined forces with the real estate sector to lobby against taxing property, and to tax labor and consumers – and industry – instead. This is the major political problem that Australia faces: the lobbying power of the symbiotic FIRE sector.

Along this same line you could enact a natural resource tax. Nature has provided Australia with subsoil wealth in the form of minerals, oil and gas with a lower cost of extraction than other countries have. So you can tax land and minerals without increasing their price. To the extent that you remove a similar volume of taxes from labour and capital, you lower the economy’s cost of living and doing business. This should be the objective, as it was to classical economists hoping to make their national economies more competitive by keeping market prices in line with actual costs of production – and making the distribution of income more fair in the process, by collecting the “free lunch” of economic rent as the natural tax base, as it was for thousands of years in wiser times.

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The tables on the following 2 pages were written by Professor Hudson to summarise the difference between Classical and NeoLiberal Economics. These are taken from a larger article entitled “How Rentier Interests Aim to Reverse Progressive Era Reforms”. This can be read in full via Michael’s new look website (the upgrade proudly funded by Prosper Australia) [www.michael-hudson.com](http://www.michael-hudson.com)