

Michael Hudson: Trade Advantage Replaced by Rent Extraction

KARL FITZGERALD INTERVIEWS MICHAEL HUDSON, RESEARCH PROFESSOR OF ECONOMICS AT UNIVERSITY OF MISSOURI, KANSAS CITY, AND A RESEARCH ASSOCIATE AT THE LEVY ECONOMICS INSTITUTE OF BARD COLLEGE, ON 3CR'S RENEGADE ECONOMISTS. HIS LATEST BOOK IS "THE BUBBLE AND BEYOND."

Karl Fitzgerald: Our favourite guest, the man that Max Keiser from www.MaxKeiser.com described as the world's greatest living economist, yes, Professor Michael Hudson is here to give us a wrap on 2013 and the economic forces that have surrounded us for centuries.

How have you actually seen 2013? What's played out for you in terms of the big trends?

Michael Hudson: Oh, the same shrinkage that you've seen since 2008. We're still in the backwash; the economy is still unable to pay its debts. The difference in trend is that now you have hedge funds coming in to the real estate market here buying a lot of properties from the banks at great discount prices for all cash.

So, for the last 30 years you've had a declining proportion of equity ownership of US real estate. All of a sudden that's turned around and gone up because you have hedge funds buying for cash. Now that you have Treasury Securities yielding only one tenth of a percent, the financial sector says "How are you we going to make a higher rate?" The highest rate they can make is in mortgages, so they're buying the discounted properties and they're renting them.

One of the consequences is that rents are going sharply up for the United States so that not only can people not afford to buy houses now, they can't get

mortgage credit, but they can't even afford to pay their rent. So the squeeze is on. Only about 25 per cent of workers' pay cheques here can be spent on goods and services, all the rest is spent on rent and social security, medical care, interest payments and taxes.

Karl: You're talking there about the growth of rental-backed securities and Blackstone Capital buying up properties at \$100million a week from what I'm reading?

Michael: That's the big change in the last year. Before 2008 you'd have home owners' mortgages that were being packed and sold and now you have the hedge funds packaging rental properties to absentee owner mortgages that are being sold. That's the change that's occurred in the structure of the financial markets this year.

Karl: And meanwhile in America there's vacancy rates of 10.2 per cent. It's staggering that people are taking this sort of pain and the Wall Street mob must be just laughing saying "Look, we can push this even further than we expected?"

Michael: That statistic you just cited is way under-reported because the banks are leaving a lot of families in the homes that haven't paid mortgages in a half-year or a year. They're not foreclosing because they know that if they do kick the people out of the homes and leave them vacant the homes are going to



be stripped of copper, stripped of any wiring and just stripped and the value will go down.

So the banks are leaving people in the homes that are not paying any mortgages just so that they'll be there and, sort of be the watch guard dogs of the home until they can be picked out and replaced with other people. But nobody sees who's going to replace them because the economy's broke.

Karl: Here in Australia we've just had our housing finance figures that revealed investors are at 38 per cent of all loans being taken out. It's shocking how rapidly this is increasing and first home owners are being crushed. They usually average around 19 – 20 per cent of the market, they're down to 12.6 per cent and in cities like Sydney, the pride and joy of Australia, first home owners are just over 7.5 per cent So we're being crowded out.

Michael: Yes, what you're described is inherently unstable. At the peak of the investment boom in the United States in 2008 speculators made up only a sixth of the market, about 16 per cent. So when you say 38 per cent of Australia, that means people have too much money, to make a long story short. They don't know where to put it, so they're putting it there without much thought of how on Earth can Australians ever pay these rents and get jobs where they have to pay so much for their income in rent? How can Australia compete, whether it's in industry or it's in services or whatever, how can it compete if people have to pay such a big portion of their pay cheque out for housing?

Karl: The wealth gap is expanding at a rate of knots and many commentators, economists are struggling

to really get a grip on where this divergence is coming from.

Michael: Yes, it's coming from the fact that for the 99 per cent, their income's going down and for the 1 per cent they're making capital gains and interest. The 1 per cent have the 99 per cent of the population in debt to themselves, so they're collecting and it's like a siphon taking all the wealth upwards. And first the 1 per cent are looking for all the income that the 99 per cent have to be pledged to pay the debt and then they want all the assets. So the wealth gap is coming.

For one thing, now people have to pay for their education and that means they have to pay so much they have to borrow, so student debt is increasing and once you graduate you have to spend the next 10 years of your life paying off the student debt. They can't afford to buy their own homes; they have to live with their parents because if they do buy a home they have to sign away the next 30 years of their life to paying the mortgage. So the entry price to get a job in this society, start a family and getting a home is running into a lifetime of debt to pay the 1%. That's why the economy's polarising.

Karl: Is it not also the element of unearned income that's being bought and sold through property transactions, any sort of buy and sell arbitrage?

Michael: Unearned income sure, if you mean capital gains, riding asset price inflation, financial speculation or just making – unearned income is getting money without working for it, getting money simply by lending money or by owning property and putting up a toll booth and charging people an access price. So the economy is putting up toll booths for education. If you want an education, you have to borrow from the bank. If you want to drive a car on a road, well, we're turning the roads into toll roads. If you want to park your car, we're now putting parking meters on the sidewalks and the parking meters' revenue's sold off in Chicago to Wall Street for the next 30 or 40 years to get money to pay the interest to Wall Street now.

So the economy's getting deeper and deeper into debt while all this is occurring. So if you look at the polarisation of wealth, you can just look at the increase in the debt ratio and that's a mirror image of it.

Karl: What I see that's interesting is that around the world we've got now these bail-in policies where depositors do come second to creditors, which is a reverse of the bedrock of the financial system. The depositors being first in line created a sense of trust

that you would be looked after and now we're seeing that not even our deposits are safe, so we might as well all just go into debt and join this Ponzi game and speculate wherever we can because savings in this day and age is virtually over?

Michael: That's not really around the world, that's in Cyprus and the only reason that was in Cyprus was most of the depositors were Russian.

Karl: In New Zealand this is the case and there are elements of it here in Australia. I've heard that in other countries too this is really moving forward.

Michael: Oh, alright, I didn't know about that. Then indeed, there's no safety. I don't know where to put the money. I would imagine people are beginning to buy gold bars. I don't know what to put it in. In America they're buying farmland, they're buying anything that's tangible that can't be wiped out.

Karl: Well that's right. Isn't it interesting that it comes back to the most trustworthy thing you can have on this planet is land in a prime location that's productive? And much of what I like to talk about here is the unearned income that can be earned by just owning a piece of property, waiting for society to develop and then being able to sell that.

Now, a lot of people have difficulties understanding the difference between rent and price. Michael, could you give us an outline on what the difference is between rent and price?

Michael: Well, this is what classical value theory was all about for about 800 years, especially from our Quesnay in France, to Adam Smith and Ricardo and John Stuart Mill. There's cost value on the one hand and almost all the cost of production, whether it's machinery or buildings or labour, all the costs can be reduced to labour. However, if there's a price that's higher than the cost of production that difference is called economic rent. So that's why people talk about rent extraction in these days.

For instance, in America about a century ago, unlike other countries, we left the electric utilities, gas companies, power utilities in private hands, like the railroads were here, and so the government developed a way of analysing what is a fair price for utilities to charge for gas, electricity, for railroads, and so it was all based on actual cost of production. The idea was you want to get rid of monopoly pricing. A monopoly pricing economic rent, monopoly rent, is when a company charges more than the cost of production, including normal profits, will reflect. And traditionally you have that

in land, in real estate, in mineral rights, in finance when banks can create money on their computer keyboard freely and then lend it out to get interest.

So rent and interest are created without any real cost of production, they're simply a result of a legal privilege, whether it's a legal privilege to erect a toll booth or to somehow impose a tariff or a special monopoly price gouging.

Karl: And what is the cause of this market power that gives them the ability to enforce these higher prices?

Michael: Usually, the failure of the government to apply anti-monopoly laws. Until Margaret Thatcher's time, Europe kept its roads, its railroads, its airlines, its gas and power utilities in the public hands. So the whole idea was that basic needs and infrastructure would be supplied to the private sector economy either at cost or at a subsidised price so that you'd made the economy more competitive. If you have to begin selling off the roads and putting toll booths there and people have to pay more for that; if you begin selling off land or real estate and the value goes up and you build public infrastructure and you don't tax it away then all this rent is going to be capitalised into a bank loan and the house is going to cost much more and you're going to increase the cost of living, and if you increase the cost of living, that'll increase the cost of labour and it'll make countries uncompetitive.

So right now you have Thatcherism and neo-Liberalism spreading throughout the world. Every country is trying to be as uncompetitive and high cost than the other country because being high cost means that somebody can borrow money against it and leave somebody else holding the bag.

Karl: So that's why trade theory in comparative advantage has really gone out the window due to this financialisation of the economy?

Michael: Yes, if you have three-quarters of the American budget going for housing, either rent or a mortgage, and for debt service and for taxes and medical care, then you no longer have the price of grain or the price of bread determining the price of labour as it did in Ricardo's day. You have really a financialisation of everybody's income and it's a rent theory of international trade instead of a cost of production theory of international trade competitiveness.

Karl: And it is bizarre when you look at the privatisation arguments that are going on around the

world, it's almost as if economies of scale have been superseded by crony competition?

Michael: It affects the markets, that's right. The whole idea now of economies of scale means the ability to control the market and extort economic rent higher than the cost of production and get a free lunch. So today's economy is all about getting a free lunch. This is exactly the opposite of everything that the classical economists thought they were pressing for.

Karl: So what nation do you see is moving in the right direction in terms of economic policy? Is there any nation, Michael?

Michael: I can't think of anyone particular. All you can say is who's avoiding the problems? China seems to be avoiding the problems for the time being. Everybody else, the Eurozone is a dead zone, they're not doing very much; the US is in the doldrums; the Third World is now in trouble, especially India; Russia hasn't really rebuilt its manufacturing base. The whole world is sort of falling apart.

This condensed interview is from a podcast produced in the studios of independent community radio station 3CR in Melbourne, Australia. The full interview can be found at: <http://podcast.3cr.org.au/pod/3CRCast-2013-12-10-93939.mp3>