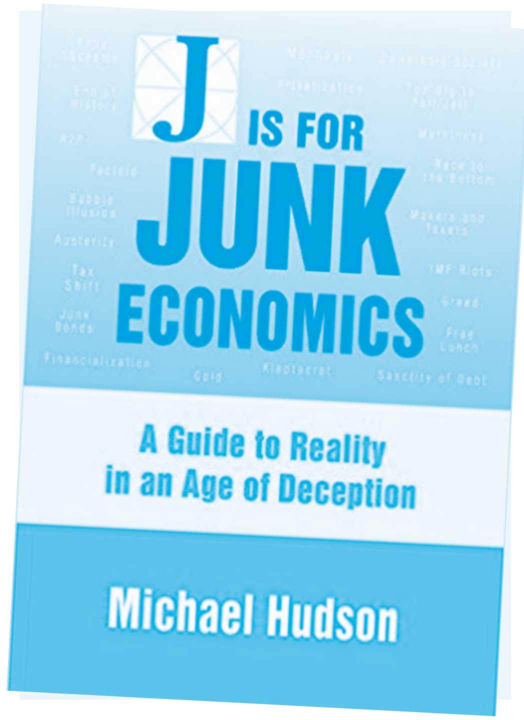
Michael Hudson

J is for Junk Economics

A Guide to Reality in an Age of Deception



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BACK TO THE CLASSICS

Modern mainstream economics represents free-market capitalism. Quoting *Adam Smith*, it calls for the state to be a mere "night watchman", interfering with economic processes as little as possible. (Of course, when the Great Recession hits, and financial institutions need to be rescued, well, that's different...)

However, the ideologists of free-market capitalism are not precise when quoting classical economists. Adam Smith and others were against the feudal state, which protected the monopolist interests of the 'landlords', the feudal lords. They wanted to restrict the monopolist state in order to enable the evolution of truly free competition in industry and services.

According to *Michael Hudson*, there are monopolist groups in the economy today, as well. They are not just based on natural monopolies, but rather on their position being legally guaranteed by the state. Hudson thoroughly examines the theory of mainstream ideology, and compares it with the practice. He comes to the astonishing conclusion that current mainstream economic theory openly serves the interest of the aforementioned monopolists, mainly by diverting attention from real problems.

The fundamental thesis of Hudson's book is that the financialisation of the economy promotes income inequality to such an extent that it leads to social problems, and sooner or later ends up compromising the functioning of the economy itself. The money created by the modern banking system, the monopoly of which belongs to the banks, generates a continuous source of income for the sector. Almost everyone comes in contact with banks, because banks not only arrange payments, but are also the source of the lending relationships interweaving the fabric of the economy. Almost everyone is a debtor. States, companies, private individuals… And the interest on those debts has become the income of the financial sector. Wage earners (in America) spend nearly three quarters of their wage on repaying loan principals and interest! This is an unbelievably high proportion! Hardly any money remains available for consumption.

Hudson notes that those who teach finance according to the traditional concepts are living in an illusory world. Today, everyone believes that the financial sector only serves the real economy, but in the meantime, through leveraging the mechanisms of credit, it has actually become the master. Most of the loans provided by the banks are not aimed at developing the real economy; rather, they finance consumption-related activities: real estate financing, consumer loans, asset purchases (car loans, card loans, student loans). The majority of loans belong to the category above. Instead of generating added value, all they essentially do is redistribute the existing amount available, as an advance on future earnings. Due to interest, this proves to be a colossal source of income for the financial sector.

Why do economic operators employ so much credit? The demand for real estate and assets is continuously increasing, borrowers want to obtain capital gains by taking out loans to purchase these types of assets. To put it frankly, such capital gains are nothing more than a form of financial speculation, sustained precisely by the demand existing due to ample credit supply. Those who expect to make a profit by selling real estates or assets purchased through loans are able do this, because the constantly flowing credit will guarantee buyers. Therefore, the demand and the price of assets continues to grow, and then – as collateral – these same assets serve to further increase the volume of lending. Thus, speculations feeds off itself, creating various asset bubbles.

The author points out, however, that in a world with compound interest, it is not realistic to expect that all debts can be repaid without limit. It is not true that *"debt does not matter"*. It is not true that *"debt is not a problem"*. Admittedly, the financial sector can indeed continue produce an almost unlimited number of loans, but a Ponzi scheme is all that results: a pyramid scheme that eventually ends in a bursting financial balloon, as a result of which, the last of the "*deceived"* end up losing a great deal. Sooner or later, insolvent debtors will cause a financial crisis! If the prices of stocks and bonds start falling, the last holders will lose a part of their invested assets.

But as a result of this crisis, the debtors will end up "relieved" of their assets! Or, more precisely, the creditors "relieve them" of such assets as mortgage collaterals, or force the debtors to sell the assets through forced privatisation. Private individuals end up losing the real estate serving as the collateral for their loan, while states are forced to privatise their assets by states of emergency.

Regarding privatisation, the author mentions that turning the infrastructure built from government taxes into private property results in the establishment of profit-oriented businesses. Ultimately, they end up making production more expensive. Ironic, considering that originally, the aim of public investment was to reduce the costs of management for private businesses! Currently, infrastructure is becoming the monopoly capital of private owners, as the goods being privatised are mainly basic and essential goods. As such goods are basic necessities, people have no choice but to pay the prices as dictated by the owner. And the consumers will not have much of a say in setting those prices. (This process was very evident in the practice of indebtedness, debt service and privatisation in Hungary.) Assets have become polarised. According to Hudson, this is not merely the spontaneous mechanism of the market, but rather the result of conscious activity. The aim of this conscious process is to acquire real assets from loans lent from the that was money created. (As Attila József put it: "*Don't let them, old man, don't put yourself in the hands of the trader, who sells clouds from the sky to buy plots on the earth*.") Hudson's idea may be called a mere conspiracy theory, but we have to admit that it is one based on evidence. (Memories of Hungarian banking supervision come to the surface again: debtors complaining about the excessive levels of collateralisation demanded by banks after the change of regime, which did not allow the provision of collateral for further loans needed for modernisation, resulting in the bankruptcy of the enterprise. As for the bank, well, they got the collateral... The consolidation of banks also comes to mind. At that time, bad debts, together with their collateral, were sold for pennies on the dollar (or rather, fillérs on the forint), thus enabling a lot of entrepreneurs close to banks to obtain capital at very low prices.)

(It should be noted that, despite the fact that commercial banks create money by lending, which poses high risks owing to the increase in debts, the biggest problems of the modern economy are caused by the activity of shadow banks, which are even less regulated than commercial banks. The main reasons for the 2008 economic crisis, which began in America, were rooted in the financial sector as a whole, and the poor regulation of financial institutions.

According to Hudson, the ideologists of the free market believe that, based on self-correction mechanisms, no debt relief is needed under any circumstances. As Hudson is an expert of ancient economic studies recognised by Harvard University, his statements based on documents and archaeological finds from Babylon and the Old Testament are very interesting: *"Debt reliefs occur regularly and cyclically in history."* The aim of debt relief is to avoid the permanent division of society! Assets should not be permanently polarised. Certain layers of society should not remain in debt bondage for their entire lives. Peace requires a strong middle class, but the existence of ostentatious fortunes in contrast with the misery of the masses creates serious tensions, and the end of peace. It is also very interesting how the author quotes *Socrates*. According to the ancient philosopher, the *"Debtor, pay!"* principle cannot always be followed, as social conditions should be taken into account, as well.

(The idea above explains Socrates's hard life to some extent. The members of the Greek aristocracy, who acted as lenders, were obviously strongly against Socrates's *"tenets misleading the youth"*.)

Hudson believes that strict insistence on the repayment of accumulated debt with compound interest is a very significant problem is today's global economy. He mentioned Greece as an example. In accordance with the interests of the lending banks, the EU forced Greece to privatise its state property and reduce wages and pensions. However, this practise fails to allow the country to restore its struggling economy. Other Mediterranean countries face similar problems, as well.

There was also a serious debate on debt relief in Hungary a long time ago. The forced repayment of Hungarian debt, as well as the use of revenues from privatisation for this purpose arguably illustrate the loss of the country's wealth. Of course, nobody forced us to accept loans under the socialist regime, but the lenders of the time certainly failed to thoroughly examine the creditworthiness of the socialist countries. They believed that the political power would enforce the repayment of such debts from the inhabitants at any price.

(See the example of the Ceausescu regime in Romania). Perhaps they believed that the Soviet Union would guarantee the repayment of its satellites' debt. Although the aforementioned loans were risky, there were no consequences for the lenders. Lenders tend to be not liable for anything. Not much debt relief takes place. The lenders followed the *"Pacta sunt servanda*" principle. (The debt reduction in Poland, forced by the political power of the American-Polish lobby was an exception.)

On the other hand, changes of regime caused transition crises in all former socialist countries, bringing about severe economic downturn. Liberalism, the prevalent ideology replacing socialism, and foreign debts also contributed to this situation. Hudson demonstrates how modern fundamentalist capitalism has swept through the whole Eastern European region. As he used to be a visiting professor at the University of Riga, he illustrates the events with an example from Lithuania. (He even mentions Hungary in a single sentence.) He points out that Lithuania was not in debt after 1990, but it has since become indebted. Similarly to other socialist countries, it had to struggle with a lack of free capital. First, banks from Northern European countries appeared in Lithuania, offering credit denominated in foreign currency. The inhabitants were delighted to take out loans. And the banks just kept on lending... As the author notes, the supervisory authorities represented the interests of foreign banks instead of those of the populace. (This attitude was certainly in compliance with the law, but we must ask: Who, then, will represent the interests of the populace?) For example, the Lithuanian Parliament passed a law according to which relatives, even aunts, uncles, were obliged to guarantee the repayment of housing loans! In the United States, apart from Hudson, several other economists *(Stiglitz, Reich)* argue for the public interest, complaining that economic policy left the populace in trouble, while using state resources to save the banks. (Based on the above, it is worth taking another look at our government's efforts to save debtors in foreign currency!) Especially at the start of the crisis, the state also took out loans to be paid back from the state's own resources. State property has been wasted, mostly sold to foreigners. Meanwhile, residents of the country have been forced into debt slavery. At the same time, many Western European experts, such as *Anders Ashlund,* mention the Baltic countries as positive examples for *"great crisis management"* in many of their publications. However, Hudson is of a different opinion. As he puts it, how can we talk about success when 20% of the population ended up emigrating? (There is a Lithuanian joke about the situation: *"The last passenger at the airport in Riga should switch off the light.")* It is easy to improve the per capita GDP if we keep decreasing the denominator... This kind of approach cannot be called reasonable economic policy or the *"restoration of balance"!*

The author's statements on the teaching of economics are worth noting as well. As he put it, in spite of being enchanted by economics (He gave up his studies in history and music to become an economist), officially, he does not teach too much about the most important socio-economic issues. Information related to debt is missing from almost all curricula at universities. Almost all information related to the history of economic theory has also been removed from the teaching materials. In Hungarian higher education, the situation is very similar. At the leading university of economics of the country, the history of economic theory has been a mere optional subject for more than a decade. Academic progress can only be achieved by publishing in leading economic journals, but they are, in a way, censored by mainstream editors. It is as if the experts served a specific ideology, without acknowledging that based on economic history and the history of economic theory, there have previously been different principles and practices from the current unrestricted free market. In addition, economic history also shows that excessive limitation of state regulation and increasing income stratification have invariably led to crises. The leading position of the world's strongest economies is due to the fact that initially, they applied protectionist policies to strengthen economic operators and prepare them for the competition. Today, thus bolstered, they can now allow competition in a free market (see: *Hamilton's* economic policy in the USA in the 19th century).

According to Hudson, we have to return to our roots! Back to the classical approach that turned against monopolies, and served real free competition. Focusing on the public interest, today's political systems should regulate legally established monopolies very strictly. But how can this be achieved, when the monopolists, principally leaders from the financial sector, are taking control over legislation in America? Becoming fed up with campaign slogans, masses are becoming totally apolitical, accepting the greedy behaviour of modern monopolies. Of course, it is possible that this situation will not last forever. It would be nice to pre-empt that moment, and bring theory closer to practice. Including, of course, the way that theory is taught.

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