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The Ideological Crisis Underlying Today's Tax and Financial Policy

America's Deceptive Fiscal Cliff

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January 406, 2013

From antiquity and for thousands of years, land, natural resources and monopolies, seaports and roads were kept in the public domain. In more recent times railroads, subway lines, airlines, and gas and electric utilities were made public. The aim was to provide their basic services at cost or at subsidized prices rather than letting them be privatized into rent-extracting opportunities. The Progressive Era capped this transition to a more equitable economy by enacting progressive income and wealth taxes.

Economies were liberating themselves from the special privileges that European feudalism and colonialism had granted to favored insiders. The aim of ending these privileges – or taxing away economic rent where it occurs naturally, as in the land's site value and natural resource rent – was to lower the costs of living and doing business. This was expected to make progressive economies more competitive, obliging other countries to follow suit or be rendered obsolete. The era of what was considered to be socialism in one form or another seemed to be at hand – rising role of the public sector as part and parcel of the evolution of technology and prosperity.

But the landowning and financial classes fought back, seeking to expunge the central policy conclusion of classical economics: the doctrine that free-lunch economic rent should serve as the tax base for economies seeking to be most efficient and fair. Imbued with academic legitimacy by the University of Chicago (which Upton Sinclair aptly named the University of Standard Oil) the new post-classical economics has adopted Milton Friedman's motto: "There Is No Such Thing As A Free Lunch" (TINSTAAFL). If it is not seen, it has less likelihood of being taxed.

The political problem faced by *rentiers* – the "idle rich" siphoning off most of the economy's gains for themselves – is to convince voters to agree that labor and consumers should be taxed rather than the financial gains of the wealthiest 1%. How long can they defer people from seeing that making interest tax-exempt pushes the government's budget further into deficit? To free financial wealth and asset-price gains from taxes – while blocking the government from financing its deficits by its own public option for money creation – the academics sponsored by financial lobbyists hijacked monetary theory, fiscal policy and economic theory in general. On seeming grounds of efficiency they claimed that government no longer should regulate Wall Street and its corporate clients. Instead of criticizing rent seeking as in earlier centuries, they depicted government as an oppressive Leviathan for using its power to protect markets from monopolies, crooked drug companies, health insurance companies and predatory finance.

This idea that a "free market" is one free for Wall Street to act without regulation can be popularized only by censoring the history of economic thought. It would not do for people to read what Adam Smith and subsequent economists actually taught about rent, taxes and the need for regulation or public ownership. Academic economics is turned into an Orwellian exercise in doublethink, designed to convince the population that the bottom 99% should pay taxes rather than the 1% that obtain most interest, dividends and capital gains. By denying that a free lunch exists, and by confusing the relationship between money and taxes, they have turned the economics discipline and much political discourse into a lobbying effort for the 1%.

Lobbyists for the 1% frame the fiscal question in terms of "How can we make the 99% pay for their own social programs?" The implicit follow-up is, "so that we (the 1%) don't have to pay?" This is how the Social Security system came to be "funded" and then "underfunded." The most regressive tax of all is the FICA payroll tax at 15.3% of wages up to about $105,000. Above that, the rich don't have to contribute. This payroll tax exceeds the income tax paid by many blue-collar families. The pretense is that not taxing these free lunchers will make economies more competitive and pull them out of depression. The reality is the opposite: Instead of taxing the wealthy on their free lunch, the tax burden raises the cost of living and doing business. This is a major reason why the U.S. economy is being de-industrialized today.

The key question is what the 1% *do* with their revenue "freed" from taxes. The answer is that they lend it out to indebt the 99%. This polarizes the economy between creditors and debtors. Over the past generation the wealthiest 1% have rewritten the tax laws to a point where they now receive an estimated 66% – two thirds – of all returns to wealth (interest, dividends, rents and capital gains), and a reported 93% of all income gains since the Wall Street bailout of September 2008.

They have used this money to finance the election campaigns of politicians committed to shifting taxes onto the 99%. They also have bought control of the major news media that shape peoples' understanding of what is happening. And as Thorstein Veblen described nearly a century ago, businessmen have become the heads most universities and directed their curriculum along "business friendly" lines.

The clearest way to analyze any financial system is to ask Who/Whom. That is because financial systems are basically a set of debts owed to creditors. In today's neo-*rentier* economy the bottom 99% (labor and consumers) owe the 1% (bondholders, stockholders and property owners). Corporate business and government bodies also are indebted to this 1%. The degree of financial polarization has sharply accelerated as the 1% are making their move to indebt the 99% – along with industry, state, local and federal government – to the point where the entire economic surplus is owed as debt service. The aim is to monopolize the economy, above all the money-creating privilege of supplying the credit that the economy needs to grow and transact business, enabling them to extract interest and other fees for this privilege.

The top 1% have nearly succeeded in siphoning off the entire surplus for themselves, receiving 93% of U.S. income growth since September 2008. Their control over the political process has enabled them to use each new financial crisis to strengthen their position by forcing companies, states and localities to relinquish property to creditors and financial investors. So after monopolizing the economic surplus, they now are seeking to transfer to themselves the economic infrastructure, land and natural resources, and any other asset on which a rent-extracting tollbooth can be placed.

The situation is akin to that of medieval Europe in the wake of the Nordic invasions. The supra-national force of Rome in feudal times is now situated in Washington, with Christianity replaced by the Washington Consensus wielded via the IMF, World Bank, WTO and its satellite institutions such as the European Central Bank, backed by the moral and ideological role academic economists rather than the Church. And on the new financial battlefield, Wall Street underwriters have used the crisis as an opportunity to press for privatization. Chicago's strong Democratic political machine sold rights to install parking meters on its sidewalks, and has tried to turn its public roads into privatized toll roads. And the city's Mayor Rahm Emanuel has used privatization of its airport services to break labor unionization, Thatcher-style. The class war is back in business, with financial tactics playing a leading role barely anticipated a century ago.

This monopolization of property is what Europe's medieval military conquests sought to achieve, and what its colonization of foreign continents replicated. But whereas it achieved this originally by military conquest of the land, today's 1% do it l by financializing the economy (although the military arm of force is not absent, to be sure, as the world saw in Chile after 1973).

The financial quandary confronting us

The economy's debt overhead has grown so large that not everyone can be paid. Rising default rates pose the question age-old question of Who/Whom. The answer almost always is that big fish eat little fish. Big banks (too big to fail) are eating little banks, while the 1% try to take the lion's share for themselves by annulling public and corporate debts owed to the 99%. Their plan is to downgrade Social Security and Medicare savings to "entitlements," as if it is a matter of sound fiscal choice not to pay low-income payers whilerentiers at the top re-christen themselves "job creators," as if they have made their gains by helping wage-earners rather than waging war against them.

The problem is not Social Security, which can be paid out of normal tax revenue, as in Germany's pay-as-you-go system. This fiscal problem – untaxing real estate, oil and gas, natural resources, monopolies and the banks – has been depicted as financial – as if one needs to save in advance by a special tax to lend to the government to cut taxes on the 99%.

The real pension cliff is with corporate, state and local pension plans, which are being underfunded and looted by financial managers. The shortfall is getting worse as the downturn reduces local tax revenues, leaving states and cities unable to fund their programs, to invest in new public infrastructure, or even to maintain and repair existing investments. Public transportation in particular is suffering, raising user fees to riders in order to pay bondholders. But it is mainly retirees who are being told to sacrifice. (The sanctimonious verb is "share" in the sacrifice, although this evidently does not apply to the 1%.)

The bank lobby would like the economy to keep trying to borrow its way out of debt and thus dig itself deeper into a financial hole that puts yet more private and public property at risk of default and foreclosure. The idea is for the government to "stabilize" the financial system by bailing out the banks – that is, doing for them what it has not been willing to do for recipients of Social Security and Medicare, or for states and localities no longer receiving revenue sharing, or for homeowners in negative equity suffering from exploding interest rates even while bank borrowing costs from the Fed have plunged. The dream is that the happy Greenspan financial bubble can be recovered, making everyone rich again, if only they will debt-leverage to bid up real estate, stock and bond prices and create new capital gains.

Realizing this dream is the only way that pension funds can pay retirees. They will be insolvent if they cannot make their scheduled 8+%, giving new meaning to the term "fictitious capital." And in the real estate market, prices will not soar again until speculators jump back in as they did prior to 2008. If student loans are not annulled, graduates face a lifetime of indentured servitude. But that is how much of colonial America was settled, after all – working off the price of their liberty, only to be plunged into the cauldron of vast real estate speculations and fortunes-by-theft on which the Republic was founded (or at least the greatest American fortunes). It was imagined that such bondage belonged only to a bygone era, not to the future of the West. But we may now look back to that era for a snapshot of our future.

The financial plan is for the government is to supply nearly free credit to the banks, so that they can to lend debtors enough – at the widest interest-rate markups in recent memory (what banks charge borrowers and credit-card users over their less-than-1% borrowing costs) – to pay down the debts that were run up before 2008.

This is not a program to increase market demand for the products of labor. It is not the kind of circular flow that economists have described as the essence of industrial capitalism. It is a financial rake-off of a magnitude such as has not existed since medieval European times, and the last stifling days of the oligarchic Roman Empire two thousand years ago.

Imagining that an economy can be grounded on these policies will further destabilize the economy rather than alleviate today's debt deflation. But if the economy is saved, the banks cannot be. This is why the Obama Administration has chosen to save the banks, not the economy. The Fed's prime directive is to keep interest rates low – to revive lending not to finance new business investment to produce more, but simply to inflate the asset prices that back the bank loans that constitute bank reserves. It is the convoluted dream of a new Bubble Economy – or more accurately a new Great Giveaway.

Here's the quandary: If the Fed keeps interest rates low, how are corporate, state and local pension plans to make the 8+% returns needed to pay their scheduled pensions? Are they to gamble more with hedge funds playing Casino Capitalism?

On the other hand, if interest rates rise, this will reduce the capitalization multiple at which banks lend against current rental income and profits. Higher interest rates will lower prices for real estate, corporate stocks and bonds, pushing the banks (and pension funds) even deeper into negative equity.

So something has to give. Either way, the financial system cannot continue along its present path. Only debt write-offs will "free" markets to resume spending on goods and services. And only a shift of taxes onto rent-yielding property and tollbooths, finance and monopolies will save prices from being loaded down with extractive overhead charges and refocus lending to finance production and employment. Unless this is done, there is no way the U.S. economy can become competitive in international markets, except of course for military hardware and intellectual property rights for escapist cultural artifacts.

The solution for Social Security, Medicare and Medicaid is to de-financialize them. Treat them like government programs for military spending, beachfront rebuilding and bank subsidies, and pay their costs out of current tax revenue and new money creation by central banks doing what they were founded to do.

Politicians shy away from confronting this solution mainly because the financial sector has sponsored a tunnel vision that ignores the role of debt, money, and the phenomena of economic rent, debt leverage and asset-price inflation that have become the defining characteristics of today's financial crisis. Government policy has been captured to try and save – or at least subsidize – a financial system that cannot be saved more than temporarily. It is being kept on life support at the cost of shrinking the economy – while true medical spending for real life support is being cut back for much of the population.

The economy is dying from a financial respiratory disease, or what the Physiocrats would have called a circulatory disorder. Instead of freeing the economy from debt, income is being diverted to pay credit card debt and mortgage debts. Students without jobs remain burdened with over $1 trillion of student debt, with the time-honored safety valve of bankruptcy closed off to them. Many graduates must live with their parents as marriage rates and family formation (and hence, new house-buying) decline. The economy is dying. That is what neoliberalism does.

Now that the debt build-up has run its course, the banking sector has put its hope in gambling on mathematical probabilities via hedge fund capitalism. This Casino Capitalist has become the stage of finance capitalism following Pension Fund capitalism – and preceding the insolvency stage of austerity and property seizures.

The open question now is whether neofeudalism will be the end stage. Austerity deepens rather than cures public budget deficits. Unlike past centuries, these deficits are not being incurred to wage war, but to pay a financial system that has become predatory on the "real" economy of production and consumption. The collapse of this system is what caused today's budget deficit. Instead of recognizing this, the Obama Administration is trying to make labor pay. Pushing wage-earners over the "fiscal cliff" to make them pay for Wall Street's financial bailout (sanctimoniously calling their taxes "user fees") can only shrink of market more, pushing the economy into a fatal combination of tax-ridden and debt-ridden fiscal and financial austerity.

The whistling in the intellectual dark that central bankers call by the technocratic term "deleveraging" (paying off the debts that have been run up) means diverting yet more income to pay the financial sector. This is antithetical to resuming economic growth and restoring employment levels. The recent lesson of European experience is that despite austerity, debt has risen from 381% of GDP in mid-2007 to 417% in mid—2012. That is what happens when economies shrink: debts mount up at arrears (and with stiff financial penalties).

But even as economies shrink, the financial sector enriches itself by turning its debt claims – what 19th-century economists called "fictitious capital" before it was called finance capital – into a property grab. This makes an unrealistic debt overhead – unrealistic because there is no way that it can be paid under existing property relations and income distribution – into a living nightmare. That is what is happening in Europe, and it is the aim of Obama Administration of Tim Geithner, Ben Bernanke, Erik Holder *et al*. They would make America look like Europe, wracked by rising unemployment, falling markets and the related syndrome of adverse social and political consequences of the financial warfare waged against labor, industry and government together. The alternative to the road to serfdom – governments strong enough to protect populations against predatory finance – turns out to be a detour along the road to debt peonage and neofeudalism.

So we are experiencing the end of a myth, or at least the end of an Orwellian rhetorical patter talk about what free markets really are. They are not free if they are to pay rent-extractors rather than producers to cover the actual costs of production. Financial markets are not free if fraudsters are not punished for writing fictitious junk mortgages and paying ratings agencies to sell "opinions" that their clients' predatory finance is sound wealth creation. A free market needs to be regulated from fraud and from rent seeking.

The other myth is that it is inflationary for central banks to monetize public spending. What increases prices is building interest and debt service, economic rent and financial charges into the cost of living and doing business. Debt-leveraging the price of housing, education and health care to make wage-earners pay over two-thirds of their income to the FIRE sector, FICA wage withholding and other taxes falling on labor are responsible for de-industrializing the economy and making it uncompetitive.

Central bank money creation is not inflationary if it funds new production and employment. But that is not what is happening today. Monetary policy has been hijacked to inflate asset prices, or at least to stem their decline, or simply to give to the banks to gamble. "The economy" is less and less the sphere of production, consumption and employment; it is more and more a sphere of credit creation to buy assets, turning profits and income into interest payments until the entire economic surplus and repertory of property is pledged for debt service.

To celebrate this as a "postindustrial society" as if it is a new kind of universe in which everyone can get rich on debt leveraging is a deception. The road leading into this trap has been baited with billions of dollars of subsidized junk economics to entice voters to act against their interests. The post-classical pro-*rentier* financial narrative is false – intentionally so. The purpose of its economic model is to make people see the world and act (or invest their money) in a way so that its backers can make money off the people who follow the illusion being subsidized. It remains the task of a new economics to revive the classical distinction between wealth and overhead, earned and unearned income, profit and *rentier* income – and ultimately between capitalism and feudalism.