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How Brazil Can Defend Against Financialization and Keep Its Economic Surplus for Itself

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ABSTRACT

The post-1945 mode of global integration has outlived its early promise. It has become exploitative rather than supportive of capital investment, public infrastructure, and living standards.

In the sphere of trade, countries need to rebuild their self-sufficiency in food grains and other basic needs. In the financial sphere, the ability of banks to create credit (loans) at almost no cost, with only a few strokes on their computer keyboards, has led North America and Europe to become debt ridden—a contagion that now threatens to move into Brazil and other BRIC countries as banks seek to finance buyouts and lend against these countries' natural resources, real estate, basic infrastructure, and industry. Speculators, arbitrageurs, and financial institutions using "free money" see these economies as easy pickings. But by obliging countries to defend themselves financially, they and their predatory credit creation are helping to bring the era of free capital movements to an end.

Does Brazil really need inflows of foreign credit for domestic spending when it can create this at home? Foreign lending ends up in its central bank, which invests its reserves in US Treasury and euro bonds that yield low returns, and whose international value is likely to decline against the BRIC currencies. Accepting credit and buyout "capital inflows" from the North thus provides a "free lunch" for key-currency issuers of dollars and euros, but it does not significantly help local economies.

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I would like to place this seminar's topic, "Global Governance," in the context of global control, which is what "governance" is mainly about. The word (from Latin *gubernari*, cognate to the Greek root *kyber*) means "steering." The question is, toward what goal is the world economy steering?

That obviously depends on who is doing the steering. It almost always has been the most powerful nations that organize the world in ways that transfer income and property to themselves. From the Roman Empire through modern Europe such transfers mainly took the form of military seizure and tribute. The Norman conquerors endowed themselves as a landed aristocracy extracting rent from the populace, as did the Nordic conquerors of France and other countries. Europe later took resources by colonial conquest, increasingly via local client oligarchies.

THE NATURAL HISTORY OF DEBT AND FINANCIALIZATION

Today, financial maneuvering and debt leverage play the role that military conquest did in times past. Its aim is still to control land, basic infrastructure, and the economic surplus—and also to gain control of national savings, commercial banking, and central bank policy. This financial conquest is achieved peacefully and even voluntarily rather than militarily. But the aim is the same: to make subject populations pay—as debtors and as dependent junior trade partners. Indebted "host economies" are in a similar position to that of defeated countries. They lose sovereignty over their own financial, economic, and tax policy as their surplus is transferred abroad. Public infrastructure is sold to foreigners who buy on credit, on which they pay interest and fees that are expensed as tax-deductible, despite being paid to foreigners.

The Washington Consensus applauds this pro-*rentier* policy. Its neoliberal ideology holds that the most efficient path to wealth is to shift economic planning out of the hands of government into those of the bankers and money managers in charge of privatizing and financializing the economy. Almost without anyone noticing, this view is replacing the classical law of nations based on the idea of sovereignty over debt and financial policy, tariff and tax policy. Ideology itself has become an economic weapon. Indebted governments have been told since 1980 to sell off their public infrastructure to foreign investors. Extractive "tollbooth" charges (a.k.a. economic rent) replace moderate or subsidized public user fees, making economies less competitive and painting them even more into a debt corner as the surplus is transferred abroad, largely tax-free.

What the world is experiencing in the face of today's globalism is a crisis in the character of nationhood and economic sovereignty. Bankers in the North look upon any economic surplus—real estate rent, corporate cash flow, or even the government's taxing power or ability to sell off public enterprises—as a source of revenue to pay interest on debts. The result is a more debt-leveraged economy in every country. Foreign investment, bank lending, the privatization of public infrastructure, and currency speculation is now managed from this bankers'-eye perspective.

There is one great exception to relinquishing national policy to foreign control: the United States itself is by far the world's largest debtor economy. While mobilizing creditor power to force other debtors to privatize their public sectors and acquiesce in a one-sided US trade protectionism, the United States is the only nation able to issue its own currency (Treasury debt) and international bank credit without limit, at a lower interest rate than any other country, and even without any foreseeable means to pay.

This double standard has transformed the character of international finance and the meaning of capital inflows. Money is no longer an asset in the form of gold or silver bullion reflecting what has been produced by labor. Money is credit, and hence finds its counterpart in debt on the liabilities side of the balance sheet. Since the United States suspended gold convertibility of the dollar in 1971, international money—the savings of central banks—has mainly taken the form of US Treasury debt, that is, loans to the United States to finance its twin balance-of-payments and budget deficits (both of which are largely military in character). Meanwhile, domestic commercial bank credit takes the form of private debt—mortgage debt, corporate debt (increasingly for debt leveraged takeovers), and even loans for speculation on financial derivatives and currency gambles.

Little bank credit has gone to finance tangible capital investment. Most such investment has been paid for out of retained business earnings, not bank loans. And as banks and brokerage houses have financed corporate takeovers, the new buyers or raiders have had to divert corporate cash flow to paying back their creditors rather than expanding production. This is how the US and other economies have become financialized and post-industrialized. Their experience should serve as an object lesson for what Brazil and other countries need to avoid.

US bank lending has been the major dynamic fueling a global inflation of real estate, stock, and bond prices, bolstered over the past decade by European bank lending. Dollar credit (like yen credit after 1990) is created "freely" without the constraint that used to occur when capital outflows forced central banks either to raise national interest rates or lose their gold stocks. In fact, *any* economy today can create its *own* domestic credit on its own computer keyboards—those of its central bank and commercial banks. Under today's conditions, foreign loans do not provide resources that host countries cannot create for themselves. The effect of foreign credit when converted into domestic currency is merely to siphon off interest and economic rent.

It is not widely recognized that most commercial bank loans merely attach debt to existing assets (above all, real estate and infrastructure) rather than being invested in creating new means of production, or to employ labor, or even to earn a profit. Banks prefer to lend against assets already in place—real estate, or entire companies—so most bank loans are used to bid up prices for assets, especially those whose prices are expected to rise by enough to pay the interest on the loan.

The fact that bankers can create interest-bearing debt at will with little cost of production poses the question of whether to leave this free lunch (economic rent) in private hands or treat money creation as a public "institutional" good. Classical economists urged that such rent-yielding privileges be regulated to keep prices and incomes in line with necessary costs of production. The surest way to do this was to keep monopolies in the public domain to provide basic services at minimum cost or for free while land taxes and user fees could serve as the main source of public revenue. This principle has been flagrantly violated by the practice of erecting privatized "tollbooths" that extract rent revenue without a corresponding cost of production. This has been done in a way that benefits only a select few.

The unchecked explosion of global credit and debt—and hence, pressure to sell off natural monopolies in the public domain—is largely a result of the credit explosion unleashed after gold convertibility ended in 1971. As noted above, the ensuing US Treasury-bill standard left foreign central banks with no vehicle in which to hold their international reserves except loans to the US Treasury. This gives the US balance-of-payments deficit a free ride, which translates into a military free ride. After the Korean War forced the dollar into deficit status in 1951, overseas military spending throughout the 1950s and 1960s equaled the entire US payments deficit. The private sector was almost exactly in balance during these decades, while US “foreign aid” actually generated a balance-of-payments surplus, as a result of aid tied to US exports rather than to the needs of aid-recipient countries.

While other countries running trade and payments deficits must increase their interest rates to stabilize their currencies, the United States has lowered its interest rates. This has increased the “capitalization rate” of its real estate rents and corporate earnings, enabling banks to lend more against higher-priced collateral. Property is worth whatever banks will lend against it, **so the US economy has been able to use the dollar standard’s free ride to load itself down with an unprecedented debt overhead—**an overhead that traditionally has been suffered only by countries fighting wars abroad or burdened with reparations payments. This is the Treasury-bill standard’s self-destructive legacy.

It is an object lesson for Brazil to avoid. Your nation today is receiving balance-of-payments inflows as foreign banks and investors create credit to lend against your real estate, natural resources, and industry. Their aim is to obtain your economic surplus in the form of interest payments and remitted earnings, turning you into a *rentier* tollbooth economy.

Why would you need these “capital inflows” that extract interest, rents, and profits as a return for electronic “computer keyboard credit” that you can create yourself? **In today’s world, no nation needs credit from abroad for domestic-currency spending at home**. Brazil should avoid letting foreign creditors capitalize its economic surplus into debt service and other payments.

The way to avoid this fate has already been outlined from the French Physiocrats and Adam Smith through John Stuart Mill and Progressive Era reformers. They recommended that by ending the special privileges bequeathed by Europe’s military conquests (privatization of land rent), and by collecting “free lunch” *rentier* income as the tax base, this revenue could be saved from being privatized and capitalized into bank loans. Taxing land and resource rent lowers the cost of living and doing business not only by removing the tax burden on labor and industry, but by holding down housing and real estate prices.

In the nineteenth century, the American system of political economy was based, correctly, on the perception that highly paid labor is more productive labor, such that well-educated, well-fed, and well-clothed labor undersells "pauper" labor. **The key to international competitiveness is thus to raise wages and living standards, not lower them**. This is especially the case for Brazil, given its need to raise labor productivity by better education, health, and social support systems if it is to thrive independently in the twenty-first century. And if it is to raise capital investment and living standards free of debt service and higher housing prices, it needs to prevent the economy's surplus from being turned into a "free lunch" in the form of land rent, resource rent, and monopoly rent—and to save this economic surplus from bankers seeking to capitalize it into debt payments. This is best achieved by taxing away the potential *rentier* charges that turn the surplus into unnecessary overhead.

THE BANKERS'-EYE VIEW OF ECONOMIES

The business plan of bank marketing departments is to capitalize any economic surplus into debt service. Loan officers see any net flow of income as potentially available to be captured as interest payments. Their dream of growth and financial success is to see the entire surplus capitalized into debt service to carry loans. Net real estate rent, corporate cash flow (ebitda: earnings before interest, taxes, depreciation and amortization), personal income above basic spending needs, and net government tax revenues thus can be capitalized into as much as banks will lend. And the more credit they lend, the higher prices are bid up for real estate, stocks, and bonds.

So bank lending is applauded for making economies richer, even as families and businesses are loaded down with more and more debt. The easier debt leveraging becomes, the more asset prices rise. Lower interest rates, lower down payments, more stretched-out amortization periods, and even fraudulent "devil may care" lending thus increases the "capitalization rate" of real estate and business revenue. This is applauded as “wealth creation”—which turns out to be debt-leveraged asset-price inflation that can infect an entire economy. It is a far cry from what Adam Smith wrote about in *The Wealth of Nations*.

The limit of this policy is reached when the entire surplus is turned into debt service. At this point the economy is fully financialized. Income spent to pay debts is not available for new investment or consumption spending, so the “real” economy is debt-shackled and must shrink.

This is why the recent financial takeoff ended in a crash. This is what much the world is witnessing today outside of Brazil and its fellow BRIC countries that have not gone so far down along the neoliberal financialization path toward its culmination in debt deflation and austerity.

THE WORLD BANK AND IMF ARE NOT REFORMABLE, BECAUSE THEY ARE BASED ON A DESTRUCTIVE ECONOMIC PHILOSOPHY

The CDES (2010) document speaks of “reforming” the IMF, World Bank, and even the United Nations. I don’t believe that this hope is realistic. As I analyzed in *Super Imperialism* (2002), the World Bank and IMF are committed to a basically destructive economic philosophy, under the euphemistic banner of “free trade” and “free and open capital markets.”

In the case of agricultural development, the World Bank is authorized only to make foreign-currency loans aimed at increasing exports. Its lending accordingly has been for roads and export infrastructure, not to develop the local economy. The Bank’s focus on plantation export crops has led to their global oversupply, lowering third world terms of trade while shifting agricultural patterns away from feeding third world populations with domestic grain crops to depend on US and European grain surpluses—at rising prices and grain-trade surpluses!

This trade pattern benefits the industrial grain-exporting nations while driving the periphery into food and debt dependency—for which “interdependence” has become the bureaucratic euphemism. I note that this happy-face word—interdependence—appears in the first sentence of this meeting’s brochure. It implies acquiescence in globalization, as if it is desirable in itself as mutually beneficial to all parties. But in today's world, interdependence implies three modes of dependency: (1) food dependency; (2) military dependency; and (3) and debt dependency. The Washington Consensus, promoted by the International Monetary Fund (IMF), World Bank, and US bilateral aid, reinforces these three modes of dependency, bolstering US financial and military hegemony.

The resulting drain of payments to creditors and absentee investors forces countries to balance their budgets by selling off their public domain. Credit rating agencies threaten to downgrade counties that do not "play ball" by giving up their commanding heights—their basic infrastructure, along with their on the land, water, and other natural resources—on the cheap. Lower bond ratings threaten to force these countries to pay much higher interest. This system traps them into letting privatizers extract economic rent.

From about 1950 to 1980, World Bank and commercial bank consortia lent governments money to put their infrastructure in place. Now that these loans are paid off, banks are lending all over again to private buyers of these assets. The new owners fully expect to erect tollbooths on this hitherto public infrastructure—and "expense" their revenue in the form of tax-deductible interest, underwriting charges, high management fees, and other largely fictitious "costs of production." Globalized accounting orthodoxy enables foreign investors to transfer their receipt of user fees and other economic rent out of the country, tax-free. This drives the host economies further into balance-of-payments deficit, leading to even more sell-offs at even steeper distress-price discounts.

FISCAL AND FINANCIAL REFORM MUST GO TOGETHER TO CREATE MORE STABLE GROWTH

The document for this conference refers to third world population growth as affecting the "relative importance of the developed countries." In times past, population provided a military advantage, as well as supplying labor for production. But finance wields dominant control today. The lead nations are willing to see Brazil and other BRIC countries grow and export enough labor-intensive goods and raw materials to pay their growing debts. What *rentier* interests want is the economic surplus, in the form of debt service (interest, amortization, and fees) and monopoly rents in the form of tollbooth charges for the roads and other public infrastructure that is being privatized. They add insult to injury by also demanding that governments refrain from taxing these takings, by permitting interest and other technologically unnecessary charges such as depreciation to be tax-deductible. An illusion of non-profit (and hence, non-taxable) business also is given by going along with the accounting pretense of fictitiously low transfer prices for exports.

Corporate accountants quantify these stratagems with an eye to leaving little net income to be reported and taxed. Under this false map of economic reality, seemingly empirical statistics serve mainly to preserve the deceptive neoliberal economic theory behind them.[1]

To keep their monopoly of money creation, creditor nations demand that governments not use their central banks to do what central banks all over the world originally were founded to do: finance public budget deficits by monetizing them to become the national credit base. The pretense is that it would be inflationary for central banks to finance their government's budget deficits. But it is no more inflationary than permitting the central banks and commercial banks of the United States and Europe to create credit on their *own* keyboards!

The European Central Bank insists that governments borrow only from commercial banks and other private-sector creditors—and even that foreign bank branches in host countries can denominate loans in the currency used by the head office or other foreign currencies. Swedish branch banks in Latvia and Austrian bank branches in Hungary thus make loans denominated in Euros. Creditor-nation banks thus can invade and conquer by creating their own local electronic credit, violating the prime directive of wise financial management: never denominate debts in hard foreign currency when your income is in soft domestic currency.

The demand that countries "balance their budgets" is a euphemism for selling off the public domain and slashing pensions and public spending on education, medical care, and other basic preconditions for raising labor productivity. Such austerity demands the opposite of the Keynesian policies followed by the United States itself. Economies subjected to the

[1] For a long history of this debate, see Zarlenga (2002).

Washington Consensus fall further and further behind, making the global economy more polarized and unstable. The collapse of the "Baltic Tigers" and other post-Soviet economies where neoliberal planners had a free hand stands as an object lesson for how self-destructive these policies are for nations that submit to them.

What is ironic is that the tax philosophy favoring debt leveraging rather than equity investment is destroying the creditor economies as well as the financialized periphery! Make no mistake: That is the blowback that Europe and North America are now experiencing. They have let free credit creation subject their own economies to debt deflation[2]—the same dysfunctional policies that have impaired third world development from the 1960s onward!

It is to prevent the resulting shrinkage of the "real" economy—and indeed, debt peonage—that European labor unions are mounting a general strike on September 28, 2010, against austerity plans that would roll back living standards. The move by the BRIC countries to create an alternative financial system and trade and development philosophy for themselves is a kindred reaction against the neo-*rentier* drive to undermine classical economic reform.

THE IMPORTANCE OF ECONOMIC IDEOLOGY TO MAKE A NEW BEGINNING

In explaining Brazil's economic strength, your advantages include your population and natural resources, but you have had these all along. What makes Brazil so attractive today is that you are not yet as debt-ridden as North America and Europe. Your economic surplus is not yet pledged to pay debt service, so in the eyes of bankers you are not as yet "loaned up."

Your main economic problem is how to protect yourself from the credit and debt explosion that has dragged down the North. Your solution must be to follow an alternative to the regressive tax ideology and privatization of natural monopolies and financial privileges being promoted by today's international institutions.

[2] I describe this economic shrinkage in Hudson (2006 and 2008).

Protecting yourself requires more than just a "global governance revision." It calls for an outright break from the past. Revision tends to be merely marginal. A more structural change is called for. And when building a new foundation, it is easier to start afresh than to try to modify bad institutions and retrain personnel committed to dysfunctional past policies.

An outstanding example of this is US policy after its Civil War. To develop the logic for their economic program, the Republican Party at that time (not today's neoliberal Republicans!) founded land-grant state colleges and endowed business schools to teach the protectionist and technology-based alternative to the British free trade doctrine being taught at the most prestigious colleges such as Harvard, Yale, and Princeton. It was these less prestigious schools that taught the doctrines that would propel the United States to world leadership by means of protective tariffs, a national bank, and public infrastructure investment.[3]

COMMENTS AND RECOMMENDATIONS ON THE FOUR OBJECTIVES CITED FOR DISCUSSION AT THIS CONFERENCE

(1) Globalization and labor markets under today's self-destructive push for austerity have been discussed and recommendations given above. Under the euphemism of "balanced budgets," fiscal austerity aims to prevent countries from creating their own public credit and using their economic surplus to raise living standards. Under austerity, government revenue is used to pay debt service, bailing out banks, and making other transfer payments or subsidies to the finance, insurance, and real estate (FIRE) sector at home and abroad rather than spent to raise productivity. This obviously should be avoided.

(2) New development indicators are indeed needed to replace the GDP accounting format with a better and more realistic map of the economy. Traditional classical doctrine divided economies into two parts: (A) the production-and-consumption sector that textbooks usually refer to as the "real" economy, and (B) the extractive FIRE sector. This dichotomy treated

[3] I describe this in Hudson (1992 and 2010).

land rent, interest and fees on bank credit, extortionate monopoly rents, and other "tollbooth"-type fees as transfer payments, not as output. But today's mainstream GDP accounts define this "unearned income"—what used to be viewed as overhead, at prices in excess of their necessary costs of production—as reflecting the cost and value of "output," as if what FIRE *rentiers* charge were a necessary part of the economy. Bankers and *rentiers* have every interest in maintaining this false dichotomy.

It is as if economists have forgotten Charles Baudelaire's quip: "The devil wins at the point where he convinces the world that he does not really exist." In particular, the GDP accounting format rejects the classical definition of economic rent as the excess of market price extracted over and above the necessary costs of production. The result is *rentiers'*-eye map of how the economy works—a view in which bankers, landlords, and monopolists play a productive role, as if all their special privileges and favored economic status were productive rather than extractive.

The GDP accounting format and national balance sheet undervalues land and other natural resources, treating them as "capital" and hence viewing their economic rent as "earnings," not unearned income. This fosters the illusion that real estate rises in price because buildings somehow are growing in value, despite being depreciated for tax purposes. This rising imputation for the valuation of buildings is at the expense of land value, and the resulting picture deters accurate analysis.

In a related "error of omission," free traders have opposed calculating the economic cost of recovering the exhaustion of mineral and subsoil wealth and forests from private exploitation. Taking resource depletion, environmental cleanup, and other restoration charges into account would reduce the gains-from-trade calculations with which neoliberal free trade theory indoctrinates students and public officials. Even more to the point, governments have been persuaded to give a depletion allowance to private investors for making holes in the ground and cutting down forests. It would be more fair for them to make payments to reimburse the national economy that is losing this patrimony or suffering environmental cleanup charges.

A stable global economy needs an accounting format that reflects a nation's ability to pay foreign debts. In 1929, the Young Plan called for such a measure, and indeed averted global financial breakdown by limiting Germany's reparations payments in the context of calculating how much foreign exchange that nation could earn (and pay) in the normal course of trade, as distinct from simply trying to pay by taking on more debt or selling assets.

When an economy is able to pay debts simply by borrowing new money or selling off assets, the debts should be deemed to have gone bad and be written down. Borrowing the interest or privatizing the public domain to pay these debts is not "equilibrium" in any meaningful sense. It becomes the kind of asset stripping that Iceland and Latvia are now suffering, and that third world countries suffered in the late 1970s and 1980s. This is the road to debt peonage, shrinking the economy, and spurring emigration of labor as well as capital flight.

(3) An unsustainable development policy directly results from both the current austerity policy and pro-*rentier* GDP map of the economy that reflects only a bankers'-eye view of the world. Debts growing at exponential rates ("the magic of compound interest") are not sustainable. Trying to pay them increases the cost of living and doing business, making indebted economies less competitive while impoverishing their population, leading to defaults both in domestic and foreign currency, and hence to social unrest.

In the nineteenth century, when trade theory was elaborated by British free traders (even if it soon was to be countered by American protectionists and other progressive economists), spending on food and other consumer goods provided the basis for labor cost comparisons among nations. Today's US trade deficit, by contrast, reflects how the cost of labor is inflated by payments to the FIRE sector. Homeowners typically pay up to 40% of their income for mortgage debt service and other carrying charges, 15% for other debt (credit card interest and fees, auto loans, student loans, etc.), 11% for FICA wage withholding for Social Security and Medicare, and about 10 to 15% in other taxes (income and excise taxes). To cap matters, the financial burden of debt-leveraged real estate and consumption is aggravated by forced saving pension set-asides turned over to money managers for financial investment in these debt-leveraged financial instruments, and "financialized" wage withholding for Social Security. Avoiding these financial liabilities by using pay-as-you plans paid out of current taxation is a more stable and reliable way to go, as Germany's experience has shown.

(4) Global governance. Who shall set the rules? And in whose interest are they to be set? When discussing austerity in (1) above, for example, we need to ask, "austerity for whom?"

The corrosive role of debt is the major problem facing countries today, and hence debt is the focus of rival plans for global governance. The most pressing policy choice is whether to write down mortgages and other debts to reflect the ability to pay. If these debts are *not* written down, the result will be debt deflation that can destroy entire economies. As homeowners and businesses have to pay their income to their bankers—not spend it on goods and services—so employment and national output must continue to shrink.

But to write down the debts would mean that banks and the wealthiest 10% of the population would to lose the financial advantage that enables them to reduce the bottom 90% to debt peonage. So far, these vested interests are dominating national economic policy in the North—and it is in the wake of the resulting debt deflation that they are looking to the BRIC economies.

SUMMARY

The maxim, "Whatever income the tax collector relinquishes is available ('free') to be pledged to creditors as interest" is the defining description of what untaxing the wealthy has meant for finance. Tax cuts on real estate, for example, leave more cash flow available to be paid to mortgage bankers, whose loans capitalize the untaxed excess into credit, enabling buyers used to bid up prices for housing and office space. This leads economies to load themselves down with debt in the name of trading up. Prices for goods and services also rise while consumer income is squeezed as lower property taxes oblige the government to make up the fiscal gap by taxing labor more and raising sales taxes.

This pro-*rentier* tax favoritism is the opposite of classical economic reforms, and is bound to fail. Its sponsors have the audacity to claim Adam Smith, J.S. Mill, and their followers as the patron saints of their neoliberal ideology. They ignore the fact that classical political economy endorsed a broadening array of public services and social support outside of the market. The United States subsidized its industrial takeoff by realizing that roads, public health, and other basic services should be provided freely rather than burdened with intrusive toll charges.

Neoliberal ideology asserts that such public investment and regulation is the "road to serfdom" and proposes in its place what may best be thought of as the real road to debt peonage—tax favoritism for debt leverage followed by debt deflation and austerity.

Politicians whose campaigns are funded by FIRE sector lobbyists have legislated tax systems that favor debt leveraging. The myth is that all credit, for whatever purpose, is a necessary cost of doing business. So interest-bearing debt is given tax favoritism. Making interest payments (but not dividends) tax-deductible favors debt leveraging, and taxing capital gains at only a fraction of wages or profits also diverts bank credit that fuels asset-price inflation. This distorts investment decisions, as does the policy of taxing capital gains at only a fraction of the rate levied on "earned" income (wages and business profits). Both policies encourage phony wealth creation via asset-price inflation. The effect is to concentrate wealth in ways that the classical economists defined as unproductive—investment seeking "economic rent" (income with no corresponding cost of production) and rising land prices that J.S. Mill called an "unearned increment."

The moral is that financial reform must go hand in hand with fiscal reform. Neoliberals disagree. Echoing Margaret Thatcher's motto, "There is No Alternative" (TINA), they ignore the alternative advocated by two centuries of classical reformers. From Adam Smith and the Physiocrats through John Stuart Mill and even Winston Churchill, the free-market platform was to tax the economic rent of land so as to keep down the price of housing and taxes that fell on labor and industry.

The Progressive Era extended the aim of minimizing economic rent in private hands by keeping natural monopolies such as transportation and communication in the public domain, or at least regulating the prices they could charge and encouraging equity rather than debt financing. The Saint-Simonians, for example, hoped to organize banks like mutual funds, providing equity credit to their customers to keep financial returns in line with what borrowers actually earn.

Today's *rentier*-sponsored political reaction against classical economics inverts these policies. Would-be privatizers of public infrastructure and monopolies seek to extract economic rent—not that they would let you in on their secret. Politicians are supported in the main by the FIRE sector, whose backers see mortgage lending and buyout loans as their major market. **The tragedy of our epoch is that most credit is extended to buy rent-extracting opportunities, not for productive capital formation**. Banks prefer to lend against property already in place—real estate or companies—than to finance new capital investment.

So we are brought back to how privatizing the public domain and financializing the economy is akin to military defeat. To defend themselves, the BRIC countries need to isolate themselves from global debt creation. The "dialogue" your conference calls for with regard to rules for "new global governance" is unlikely to reach a consensus under today's conditions in which the United States and EU, as well as the World Bank and IMF, are urging austerity. They are calling for a sacrifice of labor's Social Security and pension savings in order to extract payment for the debt overhang that has been allowed to develop. There is no discussion of increasing national competitiveness by shifting the tax burden off labor and industry onto economic rent and debt leveraging. This is a willful blind spot in today's neoliberal fiscal and financial policy.

While the few are becoming wealthy beyond their wildest dreams (or the neat patter talk found in most mainstream economics textbooks), globalization along *rentier* lines has taken a corrosive form. Instead of being a program for mutual gain, it will encourage a privatized *rentier* tollbooth economy suffering from deepening debt deflation. Given the bankers'-eye view of the world promoted by the IMF and World Bank, your task must be to stay free of their influence.

The main threat to your economic interest is today's mounting global pressure to back policies that slash living standards, capital investment, and infrastructure spending in order to pay exponentially growing private and public debts. The reality is that unless debts are written off for many countries—or at least reduced to the reasonable ability to pay without widespread foreclosures and a loss of national autonomy to central planners at the IMF—the world economy will suffer financial polarization between creditors and debtors, culminating in social collapse.

Such economic austerity and debt dependency is not necessary. There is an alternative:

> (1) Do not permit outsiders and absentee investors to drive up your currency's exchange rate by buying up your assets with "computer keyboard" credit that you do not need and can create yourself.
> (2) Do not relinquish money creation to banks aiming to extract interest by financing debt-leveraged buyouts or currency speculation.
> (3) Use your tax system and regulatory policy to encourage equity rather than debt financing, and control money-creation.
> (4) Promote the investment of Brazil's economic surplus in raising production and living standards, so as to create a positive feedback between higher wage levels and productivity, hence higher global competitiveness.

At issue is the concept of what really constitutes free markets. Are they to be free *for* financial invaders and speculators, or free *from* monopoly and special privilege? Classical nineteenth-century political economy sought to keep the "free lunch" (economic rent) from raising land and raw materials prices, and to keep financial credit creation and related monopolies for the public domain as its natural fiscal base. The aim was to promote productive "earned" income, not just assume that all income was fairly earned, and that should be the aim today for a truly free market that works for all participants.

Fortunately, Brazil and its fellow BRIC members have an opportunity to create the classical nineteenth-century version of free markets, checks and balances that has been destroyed in the North by neoliberal finance-backed politicians.

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