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# Finance Capitalism versus Industrial Capitalism: The *Rentier* Resurgence and Takeover

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## Abstract

Marx and many of his less radical contemporary reformers saw the historical role of industrial capitalism as being to clear away the legacy of feudalism—the landlords, bankers, and monopolists extracting economic rent without producing real value. However, that reform movement failed. Today, the finance, insurance, and real estate (FIRE) sector has regained control of government, creating neo-rentier economies. The aim of this postindustrial finance capitalism is the opposite of industrial capitalism as known to nineteenth-century economists: it seeks wealth primarily through the extraction of economic rent, not industrial capital formation. Tax favoritism for real estate, privatization of oil and mineral extraction, and banking and infrastructure monopolies add to the cost of living and doing business. Labor is increasingly exploited by bank debt, student debt, and credit card debt while housing and other prices are inflated on credit, leaving less income to spend on goods and services as economies suffer debt deflation. Today's new Cold War is a fight to internationalize this rentier capitalism by globally privatizing and financializing transportation, education, health care, prisons and policing, the post office and communications, and other sectors that formerly were kept in the public domain. In Western economies, such privatizations have reversed the drive of industrial capitalism. In addition to monopoly prices for privatized services, financial managers are cannibalizing industry by leveraging debt and high-dividend payouts to increase stock prices.

**JEL Classification:** B26, N20, B51

## Keywords

financialization, rentier capitalism, FIRE sector

## 1. Introduction

Today's neo-rentier economies obtain wealth mainly by rent-seeking, while financialization capitalizes real estate and monopoly rent into bank loans, stocks, and bonds. Debt leveraging to bid up prices and create capital gains on credit for this virtual wealth has been fueled by central bank quantitative easing since 2009.

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Financial engineering is replacing industrial engineering. Over 90 percent of recent US corporate income has been earmarked to raise companies' stock prices by being paid out as dividends to stockholders or spent on stock buyback programs. Many companies even borrow to buy up their own shares, thus raising their debt/equity ratios.

Households and industry are becoming debt-strapped, owing rent and debt service to the finance, insurance, and real estate (FIRE) sector. This rentier overhead leaves less wage and profit income available to spend on goods and services and brings to a close the 75-year US and European expansion begun at the end of World War II in 1945.

These rentier dynamics are the opposite of what Marx described as industrial capitalism's laws of motion. German banking was indeed financing heavy industry under Bismarck, in association with the Reichsbank and military, but elsewhere, bank lending rarely has financed new tangible means of production. What promised to be a democratic and ultimately socialist dynamic has relapsed back toward feudalism and debt peonage, with the financial class today playing the role that the landlord class did in postmedieval times.

## 2. Marx's View of the Historical Destiny of Capitalism: To Free Economies from Feudalism

The industrial capitalism that Marx described in volume 1 of *Capital* is being dismantled. He saw the historical destiny of capitalism to be to free economies from the legacy of feudalism—a hereditary warlord class imposing tributary land rent and usurious banking. He thought that as industrial capitalism evolved toward more enlightened management, and indeed toward socialism, it would replace predatory usurious finance, cutting away the economically and socially unnecessary rentier income, land rent, and financial interest and related fees for unproductive credit. Adam Smith, David Ricardo, John Stuart Mill, Joseph Proudhon, and their fellow classical economists had analyzed these phenomena, and Marx summarized their discussion in volumes 2 and 3 of *Capital* and his parallel *Theories of Surplus Value* dealing with economic rent and the mathematics of compound interest, which causes debt to grow exponentially at a higher rate than the rest of the economy.

However, Marx devoted volume 1 of *Capital* to industrial capitalism's most obvious characteristic: the drive to make profits by investing in means of production to employ wage labor to produce goods and services to sell at a markup over what labor was paid. In analyzing surplus value by adjusting profit rates to take account of outlays for plant, equipment, and materials (the "organic composition of capital"), Marx described a circular flow in which capitalist employers pay wages to their workers and invest profits not paid to employees into factories and equipment.

Finance capitalism has eroded this core circulation between labor and industrial capital. Much of the midwestern United States has been turning into a rust belt. Instead of the financial sector evolving to fund capital investment in manufacturing, industry is being financialized. Making economic gains financially, primarily by debt leverage, far outstrips making profits by hiring employees to produce goods and services.

## 3. Capitalism's Alliance of Banks with Industry to Promote Democratic Political Reform

The capitalism of Marx's day still contained many financial practices surviving from feudalism, most notably a hereditary landlord class living off the land rents, most of which were spent unproductively on servants and luxuries, not to make a profit. Those rents originated from a tax. Twenty years after the Norman Conquest, William the Conqueror in 1086 ordered compilation of the Domesday Book to calculate the yield that could be extracted as taxes from the English land that he and his companions had seized. Later, as a result of King John's overbearing fiscal demands, the Revolt of the Barons (1215–1217) and their Magna Carta enabled the leading warlords to obtain much of this rent for themselves. Marx explained that industrial capitalism was politically radical in seeking to free itself from the burden of having to support this privileged landlord class, which received income with no basis in cost value or enterprise of its own.

Industrialists sought to win markets by cutting costs below those of their competitors. That aim required freeing the entire economy from the *faux frais* of production, which were socially unnecessary charges built into the cost of living and doing business. Classical economic rent was defined as the excess of price above intrinsic cost value, the latter being ultimately reducible to labor costs. Productive labor was defined as that labor employed to create a profit, in contrast to the servants and retainers (coachmen, butlers, cooks, and others) on whom landlords spent much of their rent.

The paradigmatic form of economic rent was the ground rent paid to Europe's hereditary aristocracy. As John Stuart Mill (1817: 818) explained, landlords reaped rents (and rising land prices) "in their sleep." Ricardo (1817) pointed out a kindred form of differential rent in natural resource rent stemming from the ability of mines with high-quality ore bodies to sell their lower-cost mineral output at prices set by high-cost mines. Finally, there was monopoly rent paid to owners at choke points in the economy whereby they could extract rents without a basis in any cost outlay. Such rents logically included financial interest, fees, and penalties.

Marx saw the capitalist ideal as freeing economies from the landlord class that controlled the House of Lords in Britain and similar upper houses of government in other countries. That aim required political reform of Parliament in Britain, which meant ultimately stripping power from the House of Lords and ceding it to the House of Commons to prevent the landlords from protecting their special interests at the expense of Britain's industrial economy. The first great battle in this fight against the landed interest was won in 1846 by the repeal of the Corn Laws. The fight to limit landlord power over government culminated in the constitutional crisis of 1909–1910, when the Lords rejected the land tax imposed by the Commons. The crisis was resolved by a ruling that the Lords never again could reject a revenue bill passed by the House of Commons.

## 4. The Banking Sector Lobbies against the Real Estate Sector, 1815–1846

It may seem ironic today that Britain's banking sector was wholeheartedly behind the first great fight to minimize land rent. That alliance occurred after the Napoleonic Wars ended in 1815, which ended the French blockade against British seaborne trade and reopened the British market to lower-priced grain imports. British landlords demanded tariff protection under the Corn Laws—thereby allowing them to raise the price of food to increase the revenue and hence the capitalized rental value of their landholdings—but that rendered the economy high-cost. A successful capitalist economy would have to minimize these costs in order to win foreign markets and indeed to defend its own home market. The classical idea of a free market was one free from economic rent—from rentier income in the form of land rent.

This rent—a quasi-tax paid to the heirs of the warlord bands that conquered Britain in 1066 and the similar Viking bands that conquered other European realms—threatened to minimize foreign trade. That possibility was a threat to Europe's banking classes, whose major market was the funding of commerce by bills of exchange. The banking class arose as Europe's economy was revived by the vast looting of monetary bullion from Constantinople by the Crusaders. Bankers were permitted a loophole to avoid Christianity's ban on charging interest by taking their return in the form of *agio*, a fee for transferring money from one currency to another, including from one country to another.

Even domestic credit could use this loophole of *dry exchange*, charging agio on domestic transactions cloaked as a foreign-currency transfer, much as modern corporations use offshore banking centers today to pretend that they earn their income in tax-avoidance countries that do not charge an income tax.

If Britain could become the industrial workshop of the world, such preeminence would prove highly beneficial to the banking class for whom Ricardo was the parliamentary spokesman. Britain would enjoy an international division of labor in which it exported manufactures and imported food and raw materials from other countries specializing in primary commodities that depended on Britain for their industrial products. However, for this to happen, Britain needed a low price of labor, and that meant low food costs, which at that time were the largest items in the family budgets of wage labor. That in turn required ending the power of (a) the landlord class to protect its "free lunch" of land rent, and (b) all recipients of such unearned income.

It is hard today to imagine industrialists and bankers hand in hand promoting democratic reform against the aristocracy. But that alliance was needed in the early nineteenth century. Of course, democratic reform at that time extended only to the extent of unseating the landlord class, not protecting the interest of labor. The hollowness of the industrial and banking class's democratic rhetoric became apparent in Europe's 1848 revolutions, when the vested interests ganged up against extending democracy to the population at large once the latter had helped end landlord protection of its rents.

Of course, it was socialists who picked up the political fight after 1848. Marx later reminded a correspondent that the first plank of the *Communist Manifesto* was to socialize land rent, but he poked fun at the free market rent critics who refused to recognize that rentier-like exploitation existed in the industrial employment of wage labor. Just as landlords obtained land rent in excess of the cost of producing their crops (or renting out housing), so employers obtained profits by selling the products of wage labor at a markup. To Marx, that made industrialists part of the rentier class in principle, although the overall economic system of industrial capitalism was much different from that of postfeudal rentiers, landlords, and bankers.

## 5. The Alliance of Banking with Real Estate and Other Rent-Seeking Sectors

By examining this background of how industrial capitalism was evolving in Marx's day, we can see how overly optimistic he was regarding the drive by industrialists to strip away all unnecessary costs of production—all charges that added to price without adding to value. In that sense he was fully in tune with the classical concept of free markets as markets free *from* land rent and other forms of rentier income.

Today's mainstream economics has reversed this concept. In an Orwellian doublethink twist, the vested interests today define a free market as one free *for* the proliferation of various forms of land rent, even to the point of giving special tax advantages to absentee real estate investment, the oil and mining industries (natural resource rent), and most of all to high finance (the accounting fiction of *carried interest*, an obscure term for short-term arbitrage speculation).

Today's world has indeed freed economies from the burden of hereditary ground rent. Almost two-thirds of American families own their own homes (although the rate of homeownership has been falling steadily since the "Great Obama Evictions" that were a byproduct of the junk-mortgage crisis and the Obama bank bailouts of 2009–2016, which lowered homeowner rates from over 68 percent to 62 percent). In Europe, home ownership rates have reached 80 percent in Scandinavia, and high rates characterize the entire continent. Home ownership—and also the opportunity to purchase commercial real estate—has indeed become democratized.

But it has been democratized on credit, which is the only way for wage earners to obtain housing because otherwise they would have to spend their entire working life saving enough to buy a home. After World War II ended in 1945, banks provided the credit to purchase homes (and for speculators to buy commercial properties) by providing mortgage credit to be paid off over the course of thirty years, the likely working life of the young home buyer.

Real estate is by far the banking sector's largest market. Mortgage lending accounts for about 80 percent of US and British bank credit. It played only a minor role back in 1815, when banks focused on financing commerce and international trade. Today, we can speak of the FIRE sector as the economy's dominant rentier sector. This alliance of banking with real estate has led banks to become the major lobbyists protecting real estate owners by opposing—in the face of rising advocacy—the land tax that seemed to be the wave of the future in 1848, its intention to tax away the land's entire price gains and rent and make land the tax base—as Adam Smith had urged—instead of taxing labor and consumers or profits. Indeed, when the US income tax began to be levied in 1914, it fell only on the wealthiest 1 percent of Americans, whose taxable income consisted almost entirely of property and financial claims.

The past century has reversed that tax philosophy. On a national level, real estate has paid almost zero income tax since World War II thanks to two giveaways. The first is *fictitious depreciation*, sometimes called overdepreciation. Landlords can pretend that their buildings are losing value by claiming that they are wearing out at fictitiously high rates (which is why Donald Trump has said that he loves depreciation). However, by far the largest giveaway is that interest payments are tax deductible. Real estate is taxed locally, to be sure, but typically at only 1 percent of assessed valuation, which is less than 7 to 10 percent of the actual land rent.[1]

The basic reason why banks support tax favoritism for landlords is that whatever the tax collector relinquishes is available to be paid as interest. Mortgage bankers end up with the vast majority of land rent in the United States. When a property is put up for sale and homeowners bid against each other to buy it, the equilibrium point is where the winner is willing to pay the full rental value to the banker to obtain a mortgage. Commercial investors also are willing to pay the entire rental income to obtain a mortgage because they are after the capital gain—that is, the rise in the land's price.

The policy position of the so-called Ricardian socialists in Britain and their counterparts in France (Proudhon and others) was for the state to collect the land's economic rent as its major source of revenue. However, today's capital gains occur primarily in real estate and finance and are virtually tax-free for landlords. Owners pay no capital-gains tax as real estate prices rise or even upon sale if they use their gains to buy another property, and when landlords die, all tax liability is wiped out.

The oil and mining industries likewise are notoriously exempt from income taxation on their natural resource rents. For a long time, the depletion allowance allowed them tax credit for the oil that was sold off, enabling them to buy new oil-producing properties (or whatever they wanted) with their supposed asset loss, defined as the value to recover whatever they had emptied out. There was no real loss, of course. Oil and minerals are provided by nature.

These sectors also make themselves tax exempt on their foreign profits and rents by using *flags of convenience* registered in offshore banking centers. This ploy enables them to claim to make all their profits in Panama, Liberia, or other countries that do not charge an income tax or even have a currency of their own but use the US dollar so as to save American companies from any foreign-exchange risk.

In oil and mining, as with real estate, the banking system has become symbiotic with rent recipients, including companies extracting monopoly rent. Already in the late nineteenth century, the banking and insurance sector was recognized as *the mother of trusts*, financing its creation to extract monopoly rents over and above normal profit rates.

[1]Charts are provided in Hudson (2012, 2015).

These changes have made rent extraction much more remunerative than industrial profit-seeking—just the opposite of what classical economists urged and expected to be the most likely trajectory of capitalism. Marx expected the logic of industrial capitalism to free society from its rentier legacy and to create public infrastructure investment to lower the economy-wide cost of production. By minimizing labor's expenses that employers had to cover, this public investment would put in place the organizational network that in due course (sometimes needing a revolution, to be sure) would become a socialist economy.

Although banking developed ostensibly to serve foreign trade by the industrial nations, it became a force-in-itself undermining industrial capitalism. In Marxist terms, instead of financing the M–C–M′ circulation (money invested in capital to produce a profit and consequently yet more money), high finance has abbreviated the process to M–M′, making money purely from money and credit without tangible capital investment.

## 6. The Rentier Squeeze on Budgets: Debt Deflation as a Byproduct of Asset-Price Inflation

Democratization of home ownership meant that housing no longer was owned primarily by absentee owners extracting rent, but by owner-occupants. As home ownership spread, new buyers came to support the rentier drives to block land taxation—not realizing that rent that was not taxed would be paid to the banks as interest to absorb the rent-of-location hitherto paid to absentee landlords.

Real estate has risen in price as a result of debt leveraging. The process makes investors, speculators, and their bankers wealthy but raises the cost of housing (and commercial property) for new buyers, who are obliged to take on more debt in order to obtain secure housing. That cost is also passed on to renters, and employers ultimately are obliged to pay their labor force enough to pay these financialized housing costs.

From North America to Europe, debt deflation has become the distinguishing feature of today's economies, imposing austerity as debt service absorbs a rising share of personal and corporate income and thereby leaves less to spend on goods and services. The economy's indebted 90 percent find themselves obliged to pay more and more interest and financial fees. The corporate sector, and now also the state and local government sector, likewise are obliged to pay a rising share of their revenue to creditors.

Investors are willing to pay most of their rental income as interest to the banking sector because they hope to sell their property at some point for a capital gain. Modern finance capitalism focuses on *total returns*, defined as current income *plus* asset-price gains, above all for land and real estate (figure 1). Inasmuch as a home or other property is worth however much banks will lend against it, wealth is created primarily by financial means by banks lending a rising proportion of the value of assets pledged as collateral.

The fact that asset-price gains are largely debt-financed explains why economic growth is slowing in the United States and Europe, even as stock market and real estate prices are inflated on credit. The result is a debt-leveraged economy.

Changes in the value of the economy's land from year to year far exceeds the change in GDP. Wealth is obtained primarily by asset-price (capital) gains in the valuation of land and real estate, stocks, bonds, and creditor loans (virtual wealth), not so much by saving income (wages, profits, and rents). The magnitude of these asset-price gains tends to dwarf profits, rental income, and wages.

The tendency has been to imagine that rising prices for real estate, stocks, and bonds has been making homeowners richer. But this price rise is fueled by bank credit. A home or other property is worth however much a bank will lend against it—and banks have lent a larger and larger proportion of the home's value since 1945. For US real estate as a whole, debt has come to exceed

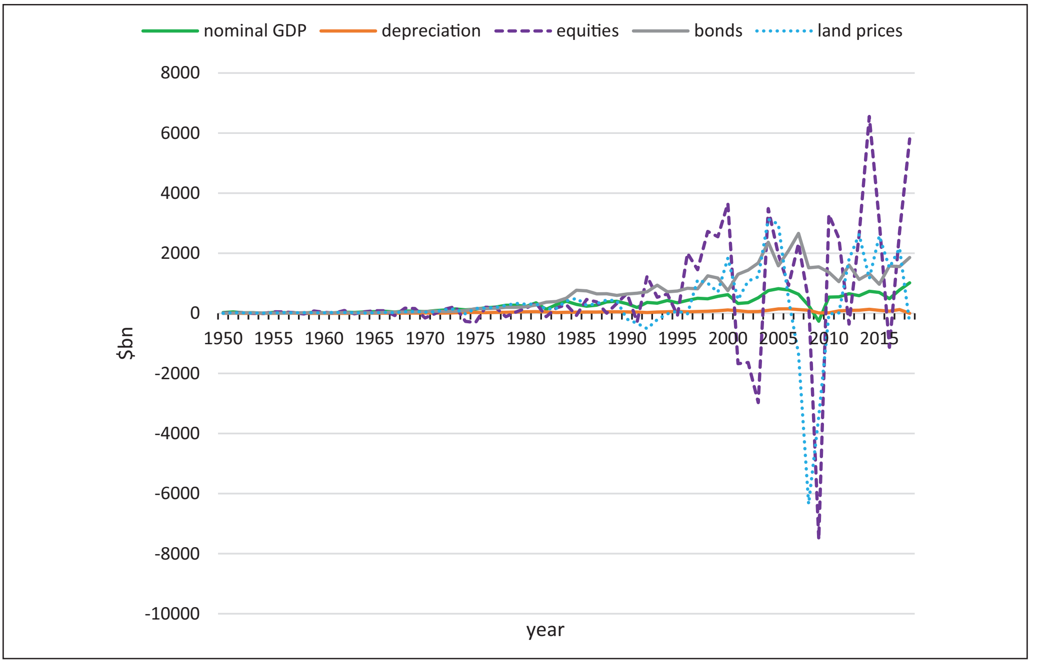


**Figure 1.** Annual Changes in GDP and the Major Components of Asset-Price Gains (nominal, $billion).

equity for more than a decade now. Rising real estate prices have made banks and speculators rich, but have left homeowners and commercial real estate debt strapped.

The economy as a whole has suffered. Debt-fueled housing costs in the United States are so high that if all Americans were given their physical consumer goods for free—their food, clothing and so forth—they still could not compete with workers in China or most other countries. That factor is a major reason why the US economy is deindustrializing. Thus, this policy of creating wealth by financialization undercuts the logic of industrial capitalism.

## 7. Finance Capital's Fight to Privatize and Monopolize Public Infrastructure

Another reason for deindustrialization is the rising cost of living stemming from conversion of public infrastructure into privatized monopolies. As the United States and Germany overtook British industrial capitalism, a major key to industrial advantage was recognized to be public investment in roads, railroads, and other transportation; education; public health; communications; and other basic infrastructure. Simon Patten (1924: 98), the first professor of economics at America's first business school, the Wharton School at the University of Pennsylvania, defined public infrastructure as a fourth factor of production in addition to labor, capital, and land. But unlike capital, Patten explained, this infrastructure's aim was not to make a profit but to minimize the cost of living and doing business by providing low-price basic services to make the private sector more competitive.

Unlike the military levies that burdened taxpayers in premodern economies, "in an industrial society the object of taxation is to increase industrial prosperity" by creating infrastructure in the form of canals and railroads, a postal service, and public education (Patten 1924: 96). This infrastructure was a fourth factor of production. Taxes would be "burdenless," Patten (1924: 96) explained, to the extent that they were invested in public internal improvements headed by transportation, such as the Erie Canal.[2]

The advantage of this public investment is to lower costs instead of letting privatizers impose monopoly rents in the form of access charges to basic infrastructure. Governments can price the services of these natural monopolies (including credit creation, as we are seeing today) at cost or offer them freely, helping labor and its employers undersell industrialists in countries lacking such public enterprise.

In the cities, Patten (1924) noted, public transport raises property prices (and hence economic rent) in the outlying periphery, similar to how the Erie Canal benefited western farms competing with upstate New York farmers. That principle is evident in today's suburban neighborhoods relative to city centers. London's Tube extension (along the Jubilee Line) and New York City's Second Avenue Subway show that underground and bus transport can be financed publicly by taxing the higher rental value created for sites along such routes. Paying for capital investment out of such tax levies can provide transportation at subsidized prices, minimizing the economy's cost structure accordingly. What Joseph Stiglitz popularized as the *Henry George law* thus more correctly should be known as *Patten's Law of burdenless taxation*.[3]

Under a regime of burdenless taxation, the return on public investment does not take the form of profit but aims at lowering the economy's overall price structure to "promote general prosperity" (Patten 1924: 98) This means that governments should operate natural monopolies directly, or at least regulate them. As Patten (1924: 98) noted, "Parks, sewers, and schools improve the health and intelligence of all classes of producers, and thus enable them to produce more cheaply, and to compete more successfully in other markets." Patten (1924: 98) concluded: "If the courts, post office, parks, gas and water works, street, river and harbor improvements, and other public works do not increase the prosperity of society they should not be conducted by the State." However, this prosperity for the overall economy was not obtained by treating public enterprises like what today is called a profit center.

In one sense, this approach can be called "privatizing the profits and socializing the losses." Advocating a mixed economy along these lines is part of the logic of industrial capitalism seeking to minimize private-sector production and employment costs in order to maximize profits. Basic social infrastructure is a subsidy to be supplied by the state.

Britain's conservative prime minister Benjamin Disraeli (1874–1880) reflected this principle: "The health of the people is really the foundation upon which all their happiness and all their powers as a state depend."[4] He sponsored the Public Health Act of 1875, followed by the Sale of Food and Drugs Act and, the next year, the Education Act. The government would provide these services, not private employers or private monopoly seekers.

For a century, public investment helped the United States pursue an economy of high wages policy, providing education, food, and health standards to make its labor more productive and thus able to undersell low-wage *pauper* labor. The aim was to create positive feedback between rising wages and increasing labor productivity.

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[2]Europe's aristocratic governments developed their tax policy "at a time when the state was a mere military organization for the defense of society from foreign foes, or to gratify national feelings by aggressive wars" (Patten 1924: 96) Such states had a passive economic development policy, and their tax philosophy was not based on economic efficiency. Details are provided in Hudson (2011).

[3]George advocated a land tax, but his opposition to socialism led him to reject the value and price concepts necessary to define economic rent quantitatively. His defense of bankers and interest rendered his policy recommendations ineffective as he moved to the libertarian right wing of the political spectrum, opposing government investment but merely taxing the rent taken by privatizers—the reverse of what Patten and his proindustrial school of economists were advocating based on classical value and price theory.

[4]Speech of June 24, 1877. He used Latin and said "Sanitas, Sanitatum" and translated it as "Sanitation, all is sanitation." It was a pun on a more famous aphorism, "Vanitas, vanitatum," "Vanity, all is vanity."

That process is in sharp contrast to today's business plan of finance capitalism—to cut wages and also cut back long-term capital investment, research, and development while privatizing public infrastructure. The neoliberal onslaught by Ronald Reagan in the United States and Margaret Thatcher in Britain in the 1980s was backed by IMF demands that debtor economies balance their budgets by selling off such public enterprises and cutting back social spending. Infrastructure services were privatized as natural monopolies, sharply raising the cost structure of such economies but creating enormous financial underwriting commissions and stock market gains for Wall Street and London.

Privatizing hitherto public monopolies has become one of the most lucrative ways to gain wealth financially. But privatized health care and medical insurance is paid for by labor and its employers, not by the government as in industrial capitalism, and in the face of the privatized educational system's rising cost, access to middle-class employment has been financed by student debt. These privatizations have not helped economies become more affluent or competitive. On an economy-wide level, this business plan is a race to the bottom, but one that benefits financial wealth at the top.

## 8. Finance Capitalism Impoverishes Economies while Increasing Their Cost Structure

*Classical economic rent* is defined as the excess of price over intrinsic cost value. Capitalizing this rent—whether land rent or monopoly rent from the privatization described above—into bonds, stocks, and bank loans creates virtual wealth. Finance capitalism's exponential credit creation increases virtual wealth—financial securities and property claims—by managing these securities and claims in a way that has made them worth more than tangible real wealth.

The major way to gain fortunes is to get asset-price gains (capital gains) on stocks, bonds, and real estate. However, this exponentially growing, debt-leveraged financial overhead polarizes the economy in ways that concentrate ownership of wealth in the hands of creditors and owners of rental real estate, stocks, and bonds, thus draining the real economy to pay the FIRE sector.

Postclassical economics depicts privatized infrastructure, natural resource development, and banking as being part of the industrial economy, not something superimposed on it by a rent-seeking class. However, the dynamic of finance-capitalist economies is for wealth not to be gained mainly by investing in industrial means of production and saving up profits or wages but to be gained by capital gains made primarily from rent-seeking. These gains are not "capital" as classically understood. They are finance-capital gains because they result from asset-price inflation fueled by debt leveraging.

By inflating its housing prices and a stock market bubble on credit, America's debt leveraging, along with its financializing and privatizing basic infrastructure, has priced it out of world markets. China and other nonfinancialized countries have avoided high health insurance costs, education costs, and other services by supplying them freely or at a low cost as a public utility. Public health and medical care costs much less abroad but that scenario is attacked in the United States by neoliberals as socialized medicine, as if financialized health care would make the US economy more efficient and competitive. Transportation likewise has been financialized and run for profit instead of to lower the cost of living and doing business.

One must conclude that America has chosen no longer to industrialize but to finance its economy by economic rent—monopoly rent from information technology, banking, and speculation—and leave industry, research, and development to other countries. Even if China and other Asian countries did not exist, there is no way that America can regain its export markets or even its internal market with its current overhead debt and its privatized and financialized education, health care, transportation, and other basic infrastructure.

The underlying problem is not competition from China but neoliberal financialization. Finance capitalism is not industrial capitalism. It is a lapse back into debt peonage and rentier neo-feudalism. Bankers play the role today that landlords played up through the nineteenth century, making fortunes without corresponding value from capital gains for real estate, stocks, and bonds on credit and from debt leveraging—whose carrying charges increase the economy's cost of living and doing business.

## 9. Today's New Cold War Is a Fight by Finance Capitalism against Industrial Capitalism

Today's world is being fractured by an economic warfare over what kind of economic system it will have. Industrial capitalism is losing the fight to finance capitalism, which has become industrial capitalism's antithesis just as industrial capitalism was the antithesis to postfeudal landlordship and predatory banking houses (see table 1).

In this respect, today's new Cold War is a conflict of economic systems. As such, it is being fought against the dynamic of US industrial capitalism as well as that of China and other economies. Thus, the struggle is domestic within the United States and Europe as well as confrontational against China, Russia, Iran, Cuba, and Venezuela and their moves to de-dollarize their economies and reject the Washington consensus and its dollar diplomacy. It is a fight by US-centered finance capital to promote neoliberal doctrine that gives special tax privileges to rentier income, untaxing land rent, natural resource rent, monopoly rent, and the financial sector. This aim includes privatizing and financializing basic infrastructure, thereby maximizing its extraction of economic rent instead of minimizing the cost of living and doing business.

The result is a war to change the character of capitalism as well as that of social democracy. The British Labour Party, European Social Democrats, and the US Democratic Party all have jumped on the neoliberal bandwagon. They are all complicit in the austerity that has spread from the Mediterranean to America's midwestern rust belt.

Finance capitalism exploits labor but via a rentier sector that also ends up cannibalizing industrial capital. This drive has become internationalized into a fight against nations that restrict the predatory dynamics of finance capital seeking to privatize and dismantle government regulatory power. The new Cold War is not merely a war being waged by finance capitalism against socialism and public ownership of the means of production. In view of the inherent dynamics of industrial capitalism requiring strong state regulatory and taxing power to check the intrusiveness of finance capital, this postindustrial global conflict is between socialism—evolving out of industrial capitalism—and fascism, defined as a rentier reaction to mobilize government to roll back social democracy and restore control to the rentier financial and monopoly classes.

The old Cold War was a fight against communism. In addition to freeing itself from land rent, interest charges, and privately appropriated industrial profits, socialism favors labor's fight for better wages and working conditions; better public investment in schools, health care, and other social welfare support; better job security; and unemployment insurance. All these reforms would cut into the profits of employers. Lower profits mean lower stock market prices and therefore fewer finance-capital gains.

The aim of finance capitalism is not to become a more productive economy by producing goods and selling them at a lower cost than competitors. What might appear at first sight to be international economic rivalry and jealousy between the United States and China is thus best seen as a fight between economic systems: that of finance capitalism versus that of a civilization trying to free itself from rentier privileges and submission to creditors through a more social philosophy of government empowered to check private interests when they act selfishly and injure society at large.

The enemy in this new Cold War is not merely socialist government but government itself, except to the extent that it can be brought under the control of high finance to promote the neoliberal rentier agenda. The most blatant example is the Trans-Pacific Partnership's proposal to create investor-state dispute settlement courts in which corporations can win compensation for

**Table 1.** Industrial Capitalism vs Finance Capitalism.

| Industrial Capitalism's Aims | Finance Capitalism's Aims |
|---|---|
| Make profits by producing products. | Extract economic rent and interest. |
| Minimize the cost of living and prices. | Add land and monopoly rent to prices. |
| Favor industry and labor. | Give special tax favoritism to the FIRE sectors. |
| Minimize land rent and housing costs by taxing land rent and other rent-yielding assets, not capital or wages. | Shift taxes off land rent taxation to leave it available to pay as interest to mortgage bankers. |
| Provide public infrastructure at low cost. | Privatize infrastructure into monopolies to extract monopoly rent. |
| Reform parliaments to block rent-seeking. Avoid military spending and wars that require running into foreign debt. | Block democratic reform by shifting control to nonelected officials. Use international organizations (such as the IMF or NATO) to force neoliberal policy. |
| Concentrate economic and social planning in the political capital. | Shift planning and resource allocation to the financial centers. |
| Concentrate monetary policy in the national treasury. | Shift monetary policy to central banks representing private commercial banking interests. |
| Bring prices in line with cost value. | Maximize opportunities for rent-seeking via land ownership, credit, and monopoly privileges. |
| Banking should be industrialized to finance tangible capital investment. | Banks lend against collateral and bid up asset prices, especially for rent-yielding assets. |
| Recycle corporate revenue into capital investment in new means of production. | Pay out revenue as dividends or use it for stock buybacks to increase stock price gains. |
| The time frame is long term to develop products and marketing plans: M–C–M′. | The time frame is short term, hit-and-run by financial speculation, M–M′. |
| Industrial engineering to raise productivity by research and development and new capital investment. | Financial engineering to raise asset prices—by stock buybacks and higher dividend payouts. |
| Focuses on long-term development of industrial capitalism as a broad economic system. | Short-term hit-and-run objectives, mainly by buying and selling assets. |
| Economy of high wages, recognizing that well-fed, well-educated labor with leisure is more productive than low-priced pauper labor and provides long-term employment. | A race to the bottom, burning out employees and replacing them with new hires. Mechanization of labor treats workers as easily replaceable and hence disposable. |
| M–C–M′ profits are made by investing in means of production and hiring labor to produce commodities to sell at a higher price than what it costs to employ labor. | M–M′ capital gains made directly by asset-price inflation. |
| Banking is industrialized to provide credit mainly to invest in new capital formation. This increased credit tends to bid up commodity prices and hence the living wage. | Increased bank credit to finance the bidding up of housing, stocks, and bonds raises the cost of housing and of buying pension income, leaving *less* to spend on goods and services. |
| Supports democracy to the extent that the lower house will back industrial capital in its fight against the landlord class and other rentiers, whose revenue adds to prices without adding value. | Finance capital joins with "late" industrial capitalism to oppose prolabor policies. It seeks to take over government, and especially central banks, to support prices for stocks, bonds, real estate, and packaged bank loans gone bad that threaten banks with insolvency. |
| Industrial capitalism is inherently nationalistic, requiring government protection and subsidy of industry. | Finance capital is cosmopolitan, seeking to prevent capital controls and impose free trade and libertarian antigovernment policy. |
| Supports a mixed economy, with government paying for infrastructure to subsidize private industry. Government works with industry and banking to create a long-term growth plan for prosperity. | Seeks to abolish government authority in all areas so as to shift the center of planning to Wall Street and other financial centers. The aim is to dismantle protection of labor and industry together. |
| Banking and credit are industrialized. | Industry is financialized, with profits used mainly to increase stock prices via stock buyback programs and dividend payouts, not new R&D or tangible investment. |
| Favor industry and labor. | Give special tax favoritism to the FIRE sectors. |

profits that would be reduced by public laws enacted to prevent environmental pollution or consumer injury, with corporate-appointed judges empowered to set the compensation. This radical limitation on public lawmaking power reverses the democratic political revolution of the nineteenth century that replaced the House of Lords and other upper houses controlled by the hereditary aristocracy with more representative legislators.

Behind corporations stand their creditors seeking to free them from any public regulations that would impair corporate profits and hence ability to sustain debt service. The implicit aim is to create a corporate state, replacing elected houses of government with central banks—the US Federal Reserve and the European Central Bank—along with external pressure from the International Monetary Fund and World Bank.

The result is a cosmopolitan financial oligarchy. That shift of economic planning and regulation to the rentier financial and monopoly classes reverses democratic government power.

Lacking foreign affluence, the US corporate state promotes employment by a military buildup and public infrastructure spending, most of which is turned over to insiders to privatize into rent-seeking monopolies and sinecures. In the United States, the military is being privatized to fight abroad (e.g., Academi née Blackwater USA), and jails are being turned into profit centers using inexpensive convict labor.

What is ironic is that although China is seeking to decouple from Western finance capitalism, it actually has been doing what the United States did in its industrial takeoff in the late nineteenth century and early twentieth. As a socialist economy, China has aimed at what industrial capitalism was expected to achieve: freeing its economy from rentier income (landlordship and usurious banking), largely by a progressive income tax policy falling mainly on rentier income.

Above all, China has kept banking in the public domain. Keeping money and credit creation public instead of privatizing it is the most important step to keep down the cost of living and business. China has been able to avoid a debt crisis by forgiving debts instead of closing down indebted enterprises deemed to be in the public interest. In these respects, it is socialist China that is achieving the outcome that industrial capitalism initially was expected to achieve in the West.

## 10. Summary: Finance Capital as Rent-Seeking

The transformation of academic economic theory under today's finance capitalism has reversed the progressive and indeed radical thrust of the classical political economy that evolved into Marxism. Postclassical theory depicts the financial and other rentier sectors as an intrinsic part of the industrial economy. Today's national income and GDP accounting formats are compiled in keeping with this anticlassical reaction depicting the FIRE sector and its allied rent-seeking sectors as an addition to national income, not a subtrahend. Interest, rents, and monopoly prices all are counted as earnings—as if all income is earned as intrinsic parts of industrial capitalism, not predatory extraction as overhead property and financial claims.

This position is the opposite of classical economics. Finance capitalism is a drive to avoid what Marx and indeed the majority of his contemporaries expected: that industrial capitalism would evolve toward socialism, peacefully or otherwise. As Assa (2017) and Assa and Kvangraven (2021) described in detail, the change is the product of decades of lobbyists fighting to transform GDP statistics to describe banks' penalty fees and indeed, any and all corporate revenue as a contribution to GDP, not as a cost. The result has been a transformation of the early GDP accounting format to a travesty that credits the financial sector as producing a product, not as imposing zero-sum transfer payments, as was formerly the case (Appelbaum and Batt 2014).[5]

[5]See also Appelbaum (2020). The GDP imputations and fictitious production are reviewed and charted in Hudson (forthcoming).

## 11. Some Final Observations: Financial Takeover of Industry, Government, and Ideology

Almost every economy is a mixed economy—public and private, financial, industrial, and rent-seeking. Within these mixed economies, the financial dynamic of debt growing by compound interest attaches itself primarily to rent-extracting privileges. Turning rent-seeking into a flow of interest payments leads the financial sector to protect them ideologically, politically, and academically. These dynamics are different from those of industrial capitalism and indeed undercut the industrial economy by diverting income from it to pay the financial sector and its rentier clients.

One expression of this inherent antagonism is the time frame. Industrial capitalism requires long-term planning to develop a product, make a marketing plan, and undertake research and development to keep undercutting competitors. The basic dynamic is M–C–M′: capital (money, M) is invested in building factories and other means of production and employing labor to sell its products (commodities, C) at a profit (M′).

Finance capitalism abbreviates this to a M–M′, making money purely financially by charging interest and making capital gains. The financial mode of wealth creation is measured by the valuations of real estate, stocks, and bonds. This valuation was long based on capitalizing their flow of revenue (rents or profits) at the going rate of interest but is now based almost entirely on capital gains as the major source of total returns.

In taking over industrial companies, financial managers focus on the short run because their salary and bonuses are based on the current year's performance. The performance in question is stock market performance. Stock prices have largely become independent from sales volume and profits now that they are enhanced by corporations typically paying out some 92 percent of their revenue in dividends and stock buybacks (Lazonick 2014; Lazonick and Shin 2020).

Even more destructively, private capital has created a new process: M–debt–M′. Farre-Mensa, Michaely, and Schmalz (2020: abstract) calculated that "over 40 percent of firms that make payouts also raise capital during the same year, resulting in 31 percent of aggregate share repurchases and dividends being externally financed, primarily with debt." This process has made the corporate sector financially fragile—above all the airline industry in the wake of the COVID-19 crisis.

Although the subject deserves more thorough elaboration than can be given here, the journalist Matt Stoller (2021: ¶13) summarized in popular terms the essential business plan of private equity:

> Financial engineers… raise large amounts of money and borrow even more to buy firms and loot them. These kinds of private equity barons aren't specialists who help finance useful products and services, they do cookie cutter deals targeting firms they believe have market power to raise prices, who can lay off workers or sell assets, and/or have some sort of legal loophole advantage. Often, they will destroy the underlying business. The giants of the industry, from Blackstone to Apollo, are the children of 1980s junk bond king and fraudster Michael Milken. They are essentially super-sized mobsters.[6]

The classic description of this looting-for-profit practice process is presented by George Akerloff and Paul Romer (1993: 2): "Firms have an incentive to go broke for profit at society's expense (to loot) instead of to go for broke (to gamble on success). Bankruptcy for profit will occur if poor accounting, lax regulation, or low penalties for abuse give owners an incentive to pay themselves more than their firms are worth and then default on their debt obligations."

The fact that paper gains from stock prices can be wiped out when financial storms occur makes financial capitalism less resilient than the industrial base of tangible capital investment

[6]See also Stoller (2020).

that remains in place. The United States has painted its economy into a corner through deindustrializing by replacing tangible capital formation with virtual wealth, that is, placing financial claims *on* income and tangible assets. Since 2009, and especially since the COVID-19 crisis of 2020, its economy has been suffering through what is called a K-shaped recovery. The stock and bond markets have reached all-time highs to benefit the wealthiest families, but the real economy of production and consumption, GDP, and employment has declined for the nonrentier sector, that is, the economy at large.

How do we explain this disparity if not by recognizing that different dynamics and laws of motion are at work? Gains in wealth increasingly take the form of a rising valuation of rentier financial and property claims *on* the real economy's assets and income, headed by rent-extraction rights, not means of production.

Finance capitalism of this sort can survive only by drawing in exponentially increasing gains from outside the system, either by central bank money creation (quantitative easing) or by financializing foreign economies, privatizing them to replace low-priced public infrastructure services with rent-seeking monopolies that issue bonds and stocks, largely financed by dollar-based credit seeking capital gains. The problem with this financial imperialism is that it makes client host economies as high-cost as their US and other sponsors in the world's financial centers.

All economic systems seek to internationalize themselves and extend their rule throughout the world. Today's revived Cold War should be understood as a fight between what kind of economic system the world will have. Finance capitalism is fighting against nations that restrict its intrusive dynamics and sponsorship of privatization and dismantling of public regulatory power. Unlike industrial capitalism, the rentier aim is not to become a more productive economy by producing goods and selling them at a lower cost than competitors. Finance capitalism's dynamics are globalist, seeking to use international organizations (the IMF, NATO, the World Bank, and US-designed trade and investment sanctions) to overrule national governments that are not controlled by the rentier classes. The aim is to make all economies into finance-capitalist layers of hereditary privilege, imposing austere antilabor policies to squeeze a dollarized surplus.

Industrial capitalism's resistance to this international pressure is necessarily nationalist because it needs state subsidy and laws to tax and regulate the FIRE sector. However, it is losing the fight to finance capitalism, which is turning into its nemesis just as industrial capitalism was the nemesis of postfeudal landlordship and predatory banking. Industrial capitalism requires state subsidy, infrastructure investment, and regulatory and taxing power to check the incursion of finance capital. The resulting global conflict is between socialism (the natural evolution of industrial capitalism) and a pro-rentier fascism, a state-finance-capitalist reaction against socialism's mobilization of state power to roll back the postfeudal rentier interests.

Underlying today's rivalry felt by the United States against China is thus a clash of economic systems. The real conflict is not so much America versus China, but finance capitalism versus industrial state capitalism/socialism. At stake is whether the state will support financialization benefiting the rentier class or build up the industrial economy and overall prosperity.

Apart from their time frame, the other major contrast between finance capitalism and industrial capitalism is the role of government. Industrial capitalism wants government to help socialize the costs by subsidizing infrastructure services. Lowering the cost of living (and hence the minimum wage) leaves more profits to be privatized. Finance capitalism wants to pry these public utilities away from the public domain and make them privatized rent-yielding assets. That step raises the economy's cost structure—and thus is self-defeating from the vantage point of international competition among industrialists.

That development is why the lowest-cost and least financialized economies have overtaken the United States, headed by China. The way that Asia, Europe, and the United States have reacted to the COVID-19 crisis highlights the contrast. The pandemic has forced an estimated 70 percent of local neighborhood restaurants to close in the face of major rent and debt arrears.

Renters, unemployed homeowners, and commercial real estate investors, as well as numerous consumer sectors, are also facing evictions and homelessness, insolvency, and foreclosure or distress sales as economic activity plunges.

Less widely noted is how the pandemic has led the Federal Reserve to subsidize the polarization and monopolization of the US economy by making credit available at only a fraction of 1 percent to banks, private equity funds, and the nation's largest corporations, helping them gobble up small and medium-sized businesses in distress.

For a decade after the Obama bank-fraud bailout in 2009, the Fed described its purpose as being to keep the banking system liquid and avoid damage to its bondholders, stockholders, and large depositors. The Fed infused the commercial banking system with enough lending power to support stock and bond prices. Liquidity was injected into the banking system by buying government securities, as was normal. But after the COVID-19 virus hit in March 2020, the Fed began to buy corporate debt for the first time, including junk bonds. Former FDIC head Sheila Bair and Treasury economist Lawrence Goodman (Bair and Goodman 2021: ¶6) noted that the Federal Reserve bought the bonds "of 'fallen angels' who sank to junk status during the pandemic" as a result of having indulged in overleveraged borrowing to pay out dividends and buy their own shares.

Bair and Goodman (2021: ¶4) further noted that Congress considered limiting companies from using the proceeds of the bonds being bought "for outsize executive compensation or shareholder distributions" at the time it approved the facilities but made no attempt to deter companies from doing this, and that "Sysco used the money to pay dividends to its shareholders while laying off a third of its workforce. . . . A House committee report found that companies benefiting from the facilities laid off more than one million workers from March to September." Bair and Goodman (2021: ¶5) concluded that "there's little evidence that the Fed's corporate debt buy-up benefited society." Just the opposite: the Fed's actions "created a further unfair opportunity for large corporations to get even bigger by purchasing competitors with government-subsidized credit" (Bair and Goodman 2021: ¶6).

The result, Bair and Goodman (2021: ¶1) accused, is transforming the economy's political shape: "The serial market bailouts by monetary authorities—first the banking system in 2008, and now the entire business world amid the pandemic" has been "a greater threat [to destroy capitalism] than Bernie Sanders." The Fed's "super-low interest rates have favored the equity of large companies over their smaller counterparts," concentrating control of the economy in the hands of firms with the largest access to such credit (Bair and Goodman 2021: ¶7).

Smaller companies are "the primary source of job creation and innovation," but do not have access to the almost free credit enjoyed by banks and their largest customers (Bair and Goodman 2021: ¶8). As a result, the financial sector remains the mother of trusts, concentrating financial and corporate wealth by financing a gobbling up of smaller companies by giant companies to monopolize the debt and bailout market.

The result of this financialized *big fish eat little fish* concentration is a modern-day version of fascism's corporate state. Radhika Desai (2020) named it *creditocracy*—rule by the institutions in control of credit.[7] It is an economic system in which central banks take over economic policy from elected political bodies and the Treasury, thereby completing the process of privatizing economy-wide control.

## Author's Note

This article is based on chapter 1 of Hudson (2021).

[7]See also Geoffrey Gardiner (1993, 2006). The post-Keynesian group Gang of 8 popularized the term *creditary economics* in the 1990s.

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