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John Henry Schlegel

University at Buffalo School of Law, schlegel@buffalo.edu

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Remembering Camelot:
Recent Adventures in Economy, Law and Politics

John Henry Schlegel*

Early in the first act of the Learner and Lowe musical, *Camelot*, the young Arthur woos Guenevere, his intended bride, by describing the glories of his kingdom. He concludes his argument: “In short, there’s simply not / A more congenial spot / For happy-ever-aftering / Than here in Camelot.” For a while it was clear that Americans lived in such a congenial spot. A large part of what made for happy-ever-aftering was its economy – a persistent market structure that fuses an understanding of economic life that seems appropriate to the place and time with the patterns of behavior within the economic, political, and social institutions that enact that understanding. In memory, this congenial spot is called, not Camelot, though a part of it, the Kennedy Administration, was called such, but rather the Post-War Economy. However, in time the economy in this remembered congenial spot became increasingly fallow. Exactly when this happened is not particularly important; it happened in different places in different times. Eventually, it became clear that the Post-War Economy was over, that the once congenial spot was now quite uncongenial. It was time to rebuild, if not Camelot, at least an equally congenial spot.

What follows is an attempt to tell the story of the coming apart of the Post-War Economy and the search for a new economy (not The New Economy) over the past 70 years. Because I am an historian of things American, I will focus on the American story, told from a particularly Northern, Rust Belt perspective, though from time to time I may advert to the broader story of the economies of the North

* Professor of Law, State University of New York Law School. Guyora, Barry, Matt, Dan, Jim, Michael, Laura, Fred, Stewart, Dan, Stephen, John, Pierre and Jim helped by taking this piece seriously.

Atlantic. However, the point of the adventure that I am inviting you, my gentle reader, on is not to get this quite long story right. As a matter of history such an objective is impossible.¹ Rather, it is to try to understand the way that the humans who lived in that congenial spot reacted to its demise. Their reaction has framed later attempts to create a persistent market structure that might replace the Post-War Economy. And so this memory of Camelot continues to inform judgments of the appropriateness of any possible set of economic relations that America might stumble into and thus helps to explain an important aspect of the economic politics of these, our times.

The common cautionary remark, be careful what you wish for, you just might get it, seldom constrains wishing. What America wished for in the aftermath of World War II was a broader and deeper middle class. And that is exactly what it got. How this wish was fulfilled is a relatively simple story, like many stories, a combination of accident and only dimly perceived intent. The accident was the results of that war which pretty much left the United States the last man standing in the graveyard as the economies of both Europe and Asia were in ruin and the other potentially vibrant economies – Argentina, Canada and South Africa – relative dwarves. The intent was legal structure of the economy that was produced during the New Deal, a structure that might be called Associationalist.

The theory behind that structure, to the extent that there was one, quite unproblematically assumed that the centerpiece of the American economy was manufacturing, especially mass manufacturing of consumer goods. It then suggested that a strong economy could be built on the basis of high, fixed prices for such goods, prices sufficient to cover manufacturers' costs comfortably. Such prices could be maintained by a combination of lax enforcement of the anti-trust laws at the

1. I would love to read a version of this story told from either a Southern or Western perspective. Unfortunately I am limited to the perspective I have.

manufacturing level, resale price maintenance agreements at the retailer level, and support of consumer demand with stable, perhaps high, wages, plus programs to provide unemployment and social security benefits. Associationalism implied a norm of “fair” competition that was to be maintained in crucial areas of the economy – particularly transportation, communications and finance – through federal regulation and in politically sensitive agriculture through both price support and regulation. Everywhere else, associations of industry participants would police themselves to ensure fair practice and expose “chiselers.”

Much of the legal part of this structure can be identified by the acronyms for the administrative agencies created (or resuscitated) by the New Deal Congresses to administer regulatory programs – CAB, FCC, FAA, FDIC, FHA, FPC, FTC, ICC, NLRB, SEC, USMC – and by the names of famous statutes – the various Agricultural Adjustment Acts and Banking Acts, the Glass-Steagall Act, the Robinson-Patman Act, the Social Security Act – less directly tied to administrative agencies. The effectiveness of such programs was not tested during the years they were enacted or during World War II. In the former years consumer demand was too low to test them; in the latter, the price of most everything was regulated and consumer goods, when available at all, sparse. However, the prosperity experienced during the twenty-five years after the end of that war seemed to validate Associationalist economic theory.

The generation of returning GIs experienced an economy growing so fast as to quiet memories of the Depression years in which they had grown up. Housing grew, manufacturing grew, vacations grew, colleges grew. Whole suburbs appeared, as did televisions, stereos, interstate highways, surprisingly inexpensive very big cars, and much bigger planes. The children of these men and women grew too, in great numbers, a Baby-Boom generation with no memory of anything other than economic

abundance. Though mocked in retrospect, for the pre-existing white middle class these years really seemed to be captured by the Nelsons and the Chevers of TV fame.

Socio-economically another change was very important. This was the great, two-part expansion of the middle class. First came a tremendous growth in white-collar jobs that accompanied the increasingly bureaucratized world of middle management in the large American corporation. Exactly why management bureaucratized in this way has never been clear. Perhaps it was a residue of life in the armed forces or of wartime production methods where documenting exactly what was done on each government contract was essential for payment. Perhaps it was just an example of the occasionally hazarded iron law of bureaucratic expansion. But whatever the reason, these were the years when, if some new task needed to be done, the American corporation hired someone to do it, rather than assigning it to an existing employee.

Only a half step behind was a second, more significant change. This was the great expansion downward of the middle class that created what might be called an hourly, as distinguished from a salaried, middle class. This broader social formation encompassed, not just the skilled tradesmen who long felt themselves to be middle class, but also the vast armies of unionized, semi-skilled workers on the production line. It was this new portion of the middle class that quickly moved into the small cape cods and ranches that sprouted like weeds in the new housing developments that defined suburban neighborhoods. These working class families choose to escape the older doubles and triples in ethnic neighborhoods (often seen as “changing,” to use the euphemism of the times) that traditionally were the lot of such working class families.

It is important to understand that this complex of social and economic changes was experienced by the returning GIs, their Baby-Boom children and, to a lesser extent, their grandchildren as a set of settled expectations of what it meant to be an

American. This was a sharply different set of expectations from those that might have seemed appropriate in the first half of the twentieth-century. Ours was God's Country. We had won The War and this transformation in American life was our proper reward.

Now it is impossible to know how much the sense of both euphoria and contentment that characterized middle class life in the Post-War Economy was made possible by the persistent market structure of these years. At the very least, the ordered set of economic relationships established by the New Deal legislation combined with Associationalist ideals to provide an implicit framework that made a focus on social life easier. Beyond that observation, however, I shall not venture, for there was a great unplanned for, unexpected circumstance that only, in retrospect, can be seen to have made the Post-War Economy possible. An American economy of high wages and high prices was easy to create because, for a good number of these post-war years, that economy faced no international economic competition. There were no other significant economies in the world.

Both Europe and Asia were prostrate. Beggars first, they needed handouts. Later, they were just as self-absorbed as were Americans during these years, though not on the project of enjoying an economy, but on that of re-building one. However, by the mid-1960s Western Europe and Japan had gained sufficient strength to begin exporting to the United States. Their exported products generally underpriced comparable American goods, both because American wages were higher and because foreign production processes were often based on newer technology. In due course such exported products were not only cheaper, but also often newly designed and of better quality than the American products they competed with.

For the following thirty years, the response of most American manufacturing firms to foreign competition consisted of a somewhat stereotypical set of moves. Disparage the foreign product, start a "Buy American" program, yell "unfair

competition” based on comparative wage rates, seek trade sanctions and, whether or not successful in securing such sanctions, either slowly cede the market in the lowest priced goods to foreign competitors or establish foreign subsidiaries and try to compete domestically by importing a foreign sourced, but domestically branded, product. Often either strategy was accompanied with complaints about “regulation” – usually labor relations, wage and hour, occupational safety and environmental – and “taxes” – primarily federal, though occasionally state and local.

Curiously, three possible responses to increased foreign competition did not occur. First, neither labor nor management moved beyond their traditional zero-sum bargaining positions toward the recognition of problems that required a joint solution. Second, no one, other than soon to be idled longshoremen, complained about the rapid decrease in the cost of ocean freight as containerization reduced the in-port labor costs of breaking bulk, the risk of theft both in transit and in port, and the cost of both rail and truck transit from port to destination. Third, only rarely did manufacturers move to make the capital investments that would have brought competitive, much less advanced, production processes to the shop floor.²

The combination of these actions and absences accompanied the slow decline in American manufacturing capacity, particularly in the consumer goods sectors that formed the core of the Associationalist economy, though also in such producer products such as cold-rolled steel. Understanding this decline is complicated by the Great Inflation which itself is pretty difficult to understand.

2. Matt Dimick has raised the important question of why such investments were not made in earlier, more flush times. I offered him a glib answer that, on reflection, does not hold up, since some firms did and some did not. My current hunch is that a sufficient answer would focus on both the history of American labor-management relations and that of the social impact of immigration. Fred Konefsky agrees with the former hunch, but is much more dubious of the latter. He suggests that the adoption of “30 and out” retirement plans in the steel industry in the early 1960s, and of subsidized early retirement in the automobile industry somewhat later, provides evidence that management in these industries knew what was going to happen as a result of its choice not to make capital investments.

From some time in the mid-1960s, best associated with Lyndon Johnson's adoption of a "guns and butter" policy for funding domestic and defense (read "Vietnam War") spending, until the very early 1980s, when the Federal Reserve Board under the chairmanship of Paul Volker slammed on the monetary breaks, the United States experienced an astonishing bout of inflation, cumulatively estimated at 200%. Economists still haven't settled their arguments about the causes of this inflation, and curiously their ideas do not seem to take sufficient account of first the embargo of oil, and then its great increase in the cost, that was OPEC's response to the American support for Israel during the Yom Kippur War. I have no interest in unraveling the relevant causal claims.

In any case, Americans experienced these years as somehow unhinged. For example, the usual benefit of inflation is that one's imports become more expensive and so fewer, even if one's exports do not become cheaper. However, during the Great Inflation such a benefit to the economy was absent since, for all practical purposes, this bout of inflation was world wide, and in fact more severe in such countries as England, France and Italy. Similarly, recessions only briefly tamed the continuous surge in prices, as neither legally enforceable or voluntary price control mechanisms had more than a temporary impact on prices.

One of the odd things that emerged from the sense that things were unhinged was the notion that at least "a," if not "the," problem with the American economy was one of over-regulation and so that "deregulation" was at least "a" cure for the ailment. The fact that the sector of the Post-War Economy that was and remained most troubled – manufacturing – was comparatively the least highly regulated seemed to bother no one. In contrast, of the main targets of deregulation, state public utilities, were not troubled at all. Nor was state or federal banking. Or telecommunications. Airlines, truckers or railroads, only extremely peripherally.

Still, deregulation was bruited about as the answer to economic sluggishness. Costs could be reduced, old services improved and new services brought forth by removing regulation and so loosing competition across the land. The results were limited. State public utilities saw little reduction of cost, other than a shift away from debt financing of capital improvement, at best an improvement to utility company balance sheets; consumers experienced no clear improvement in service. The same was mostly true of cable television, though eventually, the range of available product increased wildly, even if service was still nothing special. Telephone was probably a winner in cost reduction and expansion of product, but again debt financing was abandoned, limiting the benefit to consumers. Transportation costs were probably reduced, but at the unrecognized cost to those communities where service abandoned. Even in communities where service was maintained, quality slowly deteriorated. Banking is an entirely separate story that unfolded later, as part of the Great Moderation that followed the taming of the Great Inflation.

Just what was the Great Moderation? A book by Robert J. Samuelson brought this term to my attention, though he credited unnamed economists for having coined it.³ Samuelson asserted that it described the steady growth in the American economy that was the natural result of the ending of the Great Inflation, which he argued was caused by the hubris of academic economists of the Keynesian stripe in believing that the business cycle could be tamed through governmental action. I find this assertion dubious, even though Keynes himself emphasized the importance of the ideas of “defunct economists” for the course of economic and political events. However, for now I wish to put off my alternative explanation of these events until I have finished my story.

Still, it is true that in the early years of the Great Moderation inflation dropped precipitously and then leveled off at about 4% until the early 1990s when it declined

3. The Great Inflation and Its Aftermath (2008).

again to around 2%. While gains in productivity were unsteady, those in inflation-adjusted GDP were steadily generous. However, the decline of inflation was accompanied with a rise in the value of the dollar that made imports cheaper. Not surprisingly, the American demand for foreign imports increased and that for domestic exports decreased. The resulting trade deficits meant a continuation of the regular increase in the quantity of dollars sloshing around worldwide.

This great slosh of dollars had begun with the Marshall Plan in Europe and its unnamed cognate in equally war-ravaged Japan. Growth in exports in both Europe and Asia supported jobs there and so made these governments supportive of trade liberalization (“freer,” never “free,” trade), long an American priority, that Washington supported with the claim that the integration of economies through trade relationships would provide both a bulwark against communism and a deterrent to war among trading partners. Freer trade, denominated largely in dollars, made possible the ever-wider network that facilitated the trade in the products of manufacturing and of agriculture that came to be known by the much conjured with buzzword “globalization.”

Domestically, a similar great sloshing noise could be heard. It came from the combination of the dollar denominated earnings of foreign manufacturers and traders that they chose to invest in the United States, rather than exchange, and so repatriate, and of the rapidly accumulating funds set aside for, and by, the Baby-Boomers in contemplation of their eventual retirement. The most visible sign of the existence of this slosh was news of hostile takeovers, often of conglomerates from the 1960s, using borrowed money (hence also called leveraged buyouts). The design of these takeovers was to sell-off enough corporate assets to pay off the debt used to fund the purchase, to close down whatever was of little value, whether at the plant level or the company/division level, and then to spruce up the remaining pieces for sale, either

though a public offering or private sale. The firms that specialized in this business were essentially economic scavengers. Some were very good at it.

Scavenging was a big business in these years as the manufacturing economy continued its downward slide. The automotive industry was not a target, but it was part of the slide. Increased auto imports earned increased profits for foreign manufacturers and increased worker hostility toward foreign cars. So, while the domestic automakers were moving work to lower cost sites abroad, foreign automakers were using their profits to build plants in the United States, particularly in the union-hostile Sunbelt states. They thus maintained their quality advantage over the cars of domestic producers while they eliminated much of their transportation costs, as well as reduced, when unable to eliminate, tariff expense.

The continuing decline of this “flagship” industry caused great anxiety in the land and brought forth a torrent of discussion of how America was going to compete in the increasingly “globalized” economy without manufacturing – by which was meant mass manufacturing of consumer goods. The first (and in some sense continuing) idea was financial services, though exactly what was meant by financial services is more than a little obscure.

In the 1950s banking was highly segmented. There were commercial banks, savings banks, savings and loans, investment banks and brokerage firms. The latter two were sometimes found under the same corporate roof, but never with the first three, which never were found together at all. The Glass-Steagall Act policed the line between the first three and the final two. A mixture of state and federal law policed the lines between the first three. These three types of banks could accept savings deposits, which carried federal deposit insurance, but only the first could offer checking accounts. Checking accounts were non-interest-bearing; savings accounts were interest bearing and rates on such were regulated in such a way that allowed

savings institutions to pay a slightly higher rate of interest than did similar accounts at commercial banks.

As their name implies commercial banks primarily made money from commercial lending and so their principal assets were commercial loans. Most borrowers were corporations or very wealthy individuals, most often associated with their corporate customers. The other two bank-like institutions made money from residential mortgage lending and so their principal assets were residential mortgages. However, despite the difference in their markets, all three made money in the same way. They borrowed short (from depositors) and lent long (to borrowers). The difference between the interest paid to depositors and that paid by borrowers funded bank operations and was the source of bank profits. For these institutions income from fees was limited at best. In contrast, investment banks and brokerage firms (then exclusively partnerships) made money from fees earned by the provision of merger and acquisition advice, as well as investment banking, underwriting and brokerage services and, in addition, from “investments” of various kinds made by their partners with partnership (and sometimes personal) funds.

This tidy little set of relationships experienced its first cracks during the Great Inflation. Since banks held most of the loans they made as assets, significant inflation meant that the cost of funds soon exceeded the interest payments earned on these assets, an asset-liability mismatch. This mismatch was especially critical for savings banks and savings and loans because their assets, home loans, were made for quite long periods – 25 to 30 years – at least when compared with the effective maximum of 5 years for commercial loans. So, quite quickly, savings institutions were earning negative returns on their assets and in the name of deregulation demanded the ability to raise interest rates on deposits in order to staunch the exodus of such funds, often to the newly invented money market funds, or to longer dated, and therefore higher yielding, certificates of deposit, often brokered into large denominations by

investment banks and brokerage firms. This relief they slowly received. They also demanded the ability to make other, allegedly more lucrative, types of loans. This relief they did not, at least at first, receive.

The story of commercial banking in these years is significantly different. Commercial banks, which also experienced a significant outflow of corporate funds, though here from non-interest bearing checking accounts, as well as a less extreme negative return on assets, responded to these events in ways quite different from the savings institutions. First, they quickly moved into floating rate loans, pricing loans in terms of the changing cost of short-term funds. This shift had the effect of protecting the spread between their cost of funds and the interest paid on the loans they made and held. Second, they moved to a business model that was driven more by fee income than by interest income. Growth in fees paid, preferably up-front, and if not, at least recurrently, became the coin of the realm and the large fees paid to investment bankers and brokers were a source of envy on the part of every large bank CEO.

The social effects of the slow but continuing shrinking of the segment of the economy that was mass manufacturing of consumer goods was not wonderful to watch. Whole industries disappeared as production processes moved to either Asia or to Mexico and farther south. The impact of plant closings, much less bankruptcies, on communities, generally located in a big arc from southern Maine across New England and through the Mid-Atlantic and then the Mid-West as far as the Mississippi River and often across, was depressing and painful to experience. Even where some production persisted, the human impact was astonishing.

The impact of the disappearance of the once plentiful line jobs that, in this heavily unionized part of the country, were the economic underpinning of the hourly (lower) middle class lifestyle of trucks, ATVs, boats and summer barbeques is well known. For the past thirty years or so, the overhang of such jobless blue-collar

workers has depressed wages where and when jobs were to be had. What has not been as regularly remarked upon is the numerically smaller, but equally extreme decimation of middle management jobs that were the economic underpinning of the middle-middle class lifestyle of two sedans, vacation trips, sporting event tickets and college for the kids. Here too, wages have been stagnant for a long time. Simultaneously, individuals in the middle-middle class, and those further up the social ladder too, noticed that possession of a college degree had shifted from being a guarantee of continuing middle-middle and possibly upper-middle class status, to being the prerequisite for entrance into a professional degree program, as a professional degree had become all but required to have a shot at upper-middle class status.

The common response of lower- and middle-middle class families to the disappearance of once plentiful jobs was to turn the two-career family, once seen as the feminist legacy of the upper-middle class, into the two job family, but now understood as modest insurance against complete economic devastation when one or the other job disappears. Accompanying this shift has been both a decline in the civic life of local communities and a change in the understanding of what it means to be middle class. Once, possession of a “good” job, even though it did not come with a lifetime guarantee of employment, at least suggested a significant measure of the stability that is part of what it is to have a secure class position. By the mid-1980s, a sense of economic precariousness that had not been widely experienced in America since the Depression was added to the long-understood precariousness of health and life. Country music captures this change in the shift from Johnny Paycheck telling his boss “you can take this job and shove it” in 1977 to Ronnie Dunn telling a potential employer that he “ain’t to proud to sweep the floor” nearly 35 years later.

While these significant changes in American social life were occurring, and in contrast the European and Japanese middle classes were holding their own, three

troubling things were happening in the world of finance. The first was known as the Savings and Loan Crisis. It took a while for Congress to address the problems that savings and loans were having. When such help was finally offered the Great Inflation was largely over. Help came in the form a plan to allow these institutions to grow themselves out of their problems by being permitted to expand their lending activities into commercial real estate and some types of commercial lending.

Not wholly surprisingly, the managers of existing savings and loans were not really experienced at commercial real estate lending and even had they been, were surprised when, in 1986, a change in tax law made many of the commercial real estate loans they had made implausible business propositions. Much commercial property was simply dumped onto the market, their mortgages defaulted. Losses at savings institutions were enormous and were exacerbated by a decline in residential lending in the late 1980s as well. These two problems, when combined with a not insignificant amount of outright fraud and various varieties of chicanery, cupidity and stupidity, destroyed the savings and loan industry at a cost to the Federal entities providing deposit insurance and other support totaling about \$125 billion.

The second troubling thing in finance began as the Savings and Loan Crisis wound down. It was growth of “The New Economy,” a locution that in retrospect is more pregnant than the silliness it was attached to. These were the early days of the worldwide web portion of the Internet and the idea that underpinned The New Economy buzz was that web-based businesses were going to replace bricks and mortar stores everywhere. Venture capitalists sprang up like mushrooms after a rain. They were looking for new “ideas,” no, not new businesses, just new ideas to fund, all on the principle that first mover advantage would make early investors rich with a quick IPO on the NASDAQ, including a big first day “pop” in price. Accompanying this buzz was a great rush to build the fiber optic backbone that would support the

expected new businesses and deliver high-speed Internet service that would replace the dial-up model that AOL had pioneered for e-mail.

The flavor of the era can be had in the documentary “Startup.com,” the chronicle of a business that went from idea through first round funding to shutdown in less than a year. For a while a tsunami of money chased the stock of those dot-com startups that made it to an IPO and the first day pop in price. Indeed, from 1998 through early 2000 it seemed that there was no mountain high enough. And then the whole run-up of dot-com stocks on the NASDAQ crumbled, as it turned out the first mover advantage applied only to the few firms that were selling a product or service that people really wanted. Not surprisingly, the valuation of the companies whose only asset was the putative backbone, or even just the plan for building such, crumbled as well. And one of them, WorldCom, even brought an accounting scandal with it. While, these events cost the Federal government almost nothing beyond that of the inevitable subsequent “investigations,” lots of people lost a lot of money chasing chimera.

The story of the third troubling thing in finance – the so-called “Sub-Prime Crisis” of 2007-08 – begins back at a time when most everyone was distracted by the end of the Great Inflation and the beginnings of the Savings and Loan Crisis, though this has only become obvious in recent years. During this earlier time two things happened that would transform American banking. The first was almost invisible – the development of the Collateralized Mortgage Obligation. Originally, the CMO was nothing more than a funding option created for Freddie Mac, an organization that usually funded its purchases of home mortgages by issuing its own debt instruments. By securitizing pools of mortgages owned by Freddie Mac, this odd non-bank-bank (it accepted no deposits and so technically was not a bank) could both remove mortgages (its assets) off its books and also provide collateral to secure the resulting debt securities. This financial maneuver effectively both allowed Freddie turn a portion of

its direct borrowing into a working capital fund and to tap into a set of borrowers who preferred secured investments to general obligation bonds. In due course, Fanny Mae followed and then everyone was doing it – like rabbits. After all, there were fees to be earned from the jobs of assembling the mortgages, creating the entities that would hold the mortgages and selling the resultant securities. What was there to complain about earning fee income?

When the other thing that would transform American banking initially surfaced, it seemed to be nothing but noise. One kept hearing that American banks were “falling behind” their European and Asian peers and so were unable to compete effectively in the globalized financial markets. The implied referent competitors were the British, French and especially German “universal” banks that combined commercial banking with investment banking and broker-dealer activities (and in some cases insurance). The primary attraction of this model, to the extent that its attraction was not just “bigger is better,” was the fee income of the investment bankers and broker-dealers, and of course, the possibility of profit from proprietary investments and trading. The supposed economic selling point was to be found in the dangerous word “synergy,” in this case the idea that all financial services could be sold at one point by one company, a hoped-for “cross-selling.” All that was needed for this great benefit to appear was the supposed magic of 1980s style deregulation, a simple objective – repeal two sections of Glass-Steagall that effectively forbid such combinations.

While the debate about Glass-Steagall repeal waxed and waned two apparently isolated, and thus supposedly unrelated, financial problems briefly turned the public’s imagination from the dot-com boom and bust. The earlier problem was the implosion of a prominent hedge fund, the inaptly named Long-Term Capital Management. LTCM combined the talents of two soon to be Nobel laureates in economics with those of a famous trader from Salomon Brothers, several of his

protégées, and a former Vice-Chair of the Federal Reserve. The Nobel Prize was for a method of valuing derivatives, contractually defined investments whose value is derived (hence the name) from some other financial thing, a stock, bond, currency, interest rate, index value or the like.

Initially, LTCM specialized in trades based on the expectation that similar financial instruments with small differences in price would converge on one price. In order to be really profitable, these trades required borrowing enormous quantities of money. American and some foreign banks willingly provided this leverage. Over time, as opportunities for engaging in its initial strategy disappeared, LTCM added significant investments in both interest-rate and currency derivatives, by definition highly leveraged investments given that LTCM was a respected (and very profitable) hedge fund and so had to post little, if any, capital to secure its derivative contracts. The firm collapsed when its positions in derivatives based on Russian as well as Asian bonds simultaneously collapsed. The New York Federal Reserve Bank was forced to organize a rescue of LTCM that was funded by its major creditors.

Soon after LTCM collapsed came the Enron debacle. Lots of things can be said about Enron, but the simplest are four. It was primarily a firm that took advantage of the deregulation of public utilities. It entered into contractual agreements to provide long-term sources of energy to the newly deregulated utilities, traded the resulting contracts with others and used derivatives to hedge its obligations. Many of its actual positions, particularly losing ones, were hidden away in special-purpose vehicles, off-balance sheet entities, some of them quite misleading and maybe fraudulent. These entities were part of an effort to maintain Enron's stock price, an effort that included a nest of dubious accounting practices designed to make the company seem both more profitable and less indebted than it was.

In the ensuing scandal, some people were convicted and some of them went to jail. Enron's auditor, Arthur Anderson & Co., was likewise convicted, promptly

collapsed and was liquidated. Though the scandal is best known for prompting the passage of the Sarbanes-Oxley Act, designed to improve financial oversight of public companies, still, for present purposes, the most significant aspect of Enron was the firm's combination of off-balance sheet entities and derivatives, a combination that brought about the Sub-Prime Crisis, the aftermath of which can still be felt.

After the repeal of the relevant sections of Glass-Steagall, major American banks quickly established trading desks and pieced together the brokerage and investment banking units whose fee income they had long coveted. These units also were supposed to provide increased profits from trading gains. It was expected by all that this combination would prove that financial services could generate steadily growing profits and so permit large banks to separate themselves from the traditional norms for the valuation of bank stocks, valuations that were based on models of smaller/lesser banks. Success in this effort would pump up stock price and not incidentally management compensation. And for a while it worked.

All of the financial mechanisms necessary for accomplishing this objective were in place. Securitization was a proven technique for bundling assets and selling them and special purpose vehicles were an easy mechanism for doing so without clogging the balance sheet with assets earning low returns. Mortgage backed securities were a perfectly sensible focus for trading strategies because the banks knew their properties since they had created so many. Derivatives were both a good way to hedge risk and perfect for trading since, like mortgage-backed securities, fees were earned on their creation, and large banks were not required to post collateral to secure their outstanding contracts. The finance academics that had spread across the land from their home base at the University of Chicago assured everyone that, despite LTCM, the combination of modern portfolio theory and advanced procedures for the measurement of risk made it highly unlikely that anyone could lose a lot of money investing in securities. Crucially, the money market funds, originated way-back during

the Great Inflation, were quite willing to fund open positions in tradable assets through overnight, and sometime longer, repurchase transactions. And last, but not least, the response of the Federal Reserve to the crash of the dot-com crazed stock market was, just as would have been expected, quickly lowering interest rates. Mortgage rates joined the downward parade. Housing markets shifted into overdrive. The American Dream was on the march again.

For many people that Dream had been on hold since about 1978 when the combination of a decline in the value of the Dollar and a rise in the price of oil effectively signaled that the Post-War Economy had come to an end. Up until this point the growth of wages and the growth of productivity had roughly paralleled each other. Slowly the growth of family income, commonly measured in quintiles, began to diverge. The top quintile began to grow faster than the other four. In fifteen or so years this divergence began to show up in patterns of consumption; a public luxuriation of the consumer discretionary portion of retail markets was followed by a growth in the acceptability of, as well as a public fascination with, the display of ostentatious wealth. For those who found themselves with incomes less than might provide ostentatious wealth, maintaining lifestyles indicative of social position increasingly required the use of debt in the form of home equity loans, exotic varieties of mortgages and heavy credit card borrowings for personal consumption. Thus, it came to be the case in parts of the consumer economy that carrying large amounts of personal debt became acceptable. The financial services behemoths gorged on the resulting obligations.

What happened next is the stuff of legend and a whole shelf of books. Money was made until it wasn't and then whole edifice collapsed as first, the rise in value of houses nationwide, but especially in hot markets, stalled, then tumbled. Next, the value of off-balance sheet vehicles holding mortgages on homes in these hot markets, or securities based on them, was questioned and so these assets had to be returned to

bank balance sheets. Thereafter, asset values became equally difficult to measure and so overnight funding became difficult to acquire. With asset values questionable and leverage removed, fire sales were the order of the day. They drove mark-to-market accounting of retained assets lower. Profits vanished; losses drowned quarterly reports; stock prices tanked. Only Federal intervention on a scale undreamed of ever before saved the system. Meanwhile, no one seemed to care about the borrowers whose houses had plunged in value, much less lost jobs in the accompanying general economic slowdown.

It is a mistake to call this crisis one in sub-prime residential mortgages. There were plenty of these mortgages that should have not been written, as well as many that were implausibly said to be of higher quality. All of this dubious underwriting of mortgages and mortgage backed securities was part of the search for fee income on the part of mortgage brokers, bankers and traders. However, securitization can and did work with lots of other things including credit card receivables, bank loans, commercial mortgages and even pieces (tranches) of already existing securities evidencing prior securitizations. If there had been a larger pool of such other assets to securitize, then the crisis would have been named for such assets. But there were no larger pools anywhere in America. Everyone had to own a home. Doing so was part of the American Dream. So, we are stuck with this name. The only good thing about the name is that everyone knows it. The only bad thing about the name is that it obscures both the way that the creation of the large bank model of economic growth through the provision of financial services has deep roots in the demise of the Post-War Economy and the way that the memory of that economy haunts the politics of today. It is to these two questions that I now turn, and in that order.

My gentle reader might take the occasion of this section break to scream, "If it is just these two questions that you are going to answer, get on with it! What was the

point of this long shaggy dog story or fish on a plank recipe?” My answer is simple. I believe that what I have to say is significantly counter to what, in Leonard Cohen’s words, “Everybody knows.” I doubt that, faced with a one paragraph listing of the relevant events, any but the most gullible of readers would buy the observations I offer in the following pages. I don’t wish to speak to the gullible, but to the thoughtful, if quizzical, reader, toward whom I have attempted to show respect by the provision of enough detail to permit the fashioning of other answers, or possibly even other questions, than the two I address below. In the language of my youth, my ideal reader is from Missouri and stubbornly says, “You gotta show me.” So, I have first shown and now I will try to tell.

The Post-War Economy delivered what Americans wished for – a broader and deeper middle class. Yet, in so wishing, Americans were not careful. They did not understand that economic change is not necessarily a permanent ratcheting up. And so, they were anything but attentive when, in 1962, the first hint of the passing of the Post-War Economy appeared. By then Europeans had begun borrowing at the cheap regulated rates available in the American market and moving those dollars abroad for investment at the higher European rates. The American response to this pesky gnat of a problem was to propose an interest equalization tax designed to tax the buyers of the bonds issued by European borrowers.

I doubt that many, if any, Americans understood that this bit of transatlantic financial arbitrage was evidence of the end of the economic isolation that made the Post-War Economy possible. I know I did not; indeed it took me until the late 1980s to understand the latent meaning this bit of tax law arcana. But that Americans felt this change fairly soon seems to me evidenced by the Great Inflation. Whatever it turned out to be in the end, at the beginning, when it was a matter of guns and butter, the point of “and butter” was to keep the promise of the Post-War Economy alive.

And that this attempt didn't work, that inflation galloped ever faster to the bewilderment of the assembled multitudes, re-emphasizes that such was the point of "and butter." The structure that was so comfortable to us, that had allowed America to expand the middle class both out broader and down deeper, was not supposed to run off the rails as economic life did in the 1970s.

Then, after life comes apart, what would one expect humans to do? Try to fashion another comfortable life, a new economy, a new persistent market structure that fuses an understanding of economic life that seems appropriate to the place and time with the patterns of behavior within the economic, political, and social institutions that enact that understanding. This is what Americans tried to do during the anything but moderate Great Moderation, against the background of a variety of economic thought, associated with the University of Chicago, that emphasized the need for less regulation, freer markets that could be expected to be self-correcting and the rightness of differential economic rewards in the market for talent.

The first attempt to fashion such a structure was timid – deregulation. That idea didn't seem to do much to help or to harm the economy, at least until it was too late for it to appear as a modestly coherent idea, as opposed to a loaded political slogan. Thereafter, came the never explicit, but always implicit, idea of building an economy around the provision of housing, that most important part of the storied, but never coherent, American Dream.

This somewhat later attempt at establishing a different persistent market structure with a positive program of housing expansion made a certain sense. After all, it was the great post-war expansion of housing into the middle class suburb that seemed to epitomize the economy of those years. And, at least in growing areas of the South and West, it seemed to work, until it didn't, until a lull in home construction brought the entire savings and loan industry into ruin.

In retrospect, it turned out to be significant that this debacle was easily ascribed to the actions of thieves and charlatans. If it were just bad people who caused a financial crisis, then maybe housing was not such a bad base on which to anchor a new economy. After all, unlike deregulation, which brought job loss, housing had the important benefit of supporting a large number of hourly working class jobs. We might, and did, try it again. But before we tried housing a second time there came the dot-com craze.

It is not a trivial accident that this boom was said to be rooted in “The,” not “A,” but The New Economy. Here was an explicit attempt to forge the answer to the continuing disappearance of the Post-War Economy. All of economic life was going to revolve around the Internet and its Web. The computer geeks were to inherit the earth, a frightening idea, but still a real idea that might, and did, capture some people’s imagination. The fact that it was completely unclear how most Americans were going to earn a living in this economy should have caused people to worry. Luckily, the idea had such a short half-life that it is not surprising that few people had to confront this lack of clarity.

Almost immediately afterward, Americans slid into the idea of grounding the economy in financial services. The quants, the math nerds, were going to inherit the earth. That this idea got any traction after first Long-Term Capital Management and then Enron imploded is one of the great mysteries of the past forty years. The tie of financial services to housing, accidental as it was, and of housing to the American Dream, probably explains part of the attraction. But still, exactly how finance would provide jobs for the entire lower middle class was never clear beyond the ritual repetition of the mantra “education,” a prescription for helping a portion of the public that, while anything but dumb, still had already voted with its feet for the proposition that butts in the seat education was not for them. Unfortunately, this time “luckily” cannot preface the observation that the idea did not last very long.

There is a stream of thought that suggests that starting with the savings and loan crisis, and maybe with deregulation more generally, the point of all of these various attempts to create a persistent market structure was to make great gobs of money at the expense of the sea of rubes that is sometimes referred to as “My fellow Americans.” I suppose that there is something to this idea. After all, the world has never experienced a shortage of thieves and charlatans. Yet, there is a sameness to all of the stories of boom and bust that can be told while still remembering that “There’s one born every minute.”

The endless outrage about executive and trader compensation, as well as of the compensation secured by venture capitalists, as well as managers of hedge fund and private equity firms, not to mention the endlessly repeated laments about the short-term horizon of investors (part of the implicit contrast that provides the grounds for the claim to capitalist sainthood of the Sage of Omaha) is, at bottom, a complaint about an attitude of “Get mine and get out” on the part of the already wealthy. Contrast this attitude with that of the similarly situated Pooh-Bahs of the 1950s for whom patience was the watchword that accompanied the accumulation of quite significant amount of income. “Get mine and get out,” screams a lack of faith that any persistent market structure is about to emerge. Putting off a payday today runs the serious risk, if only in the current Pooh-Bahs’ heads, that there will be no payday tomorrow. Greed there almost certainly may be, but fear based on the perceived fragility of one’s economic and social position, not fear that the various economic police will come knocking at the door, is to be found there too.

It seems to me that the recognition of the fragility of one’s economic and social position that comes from knowing, if only implicitly, that we no longer live in a persistent market structure that defines an economy, but instead are adrift in economic life, explains a significant part of politics today. Consider first the small entrepreneur. This person’s sense of economic fragility translates into a plan to build

fast and then sell out. The ideal is to take one's money off the table as soon as one can get either a strategic buyer or the private equity guys to come to call. Larger, more complicated enterprises react to this fear of the fragility of position with relentless cost cutting. Outsource this function, cut back on that, shave wages or at the least put off raising them as long as possible, all pass for strategic thinking and all are heard daily across the land. The contrast between this mindset and that of the Post-War corporate mindset of comfortable competition based on product differentiation, coupled with the occasional night sweats over the possibility that a competitor could develop a breakout new product, is stark. It provides a good clue to the fact that we are nowhere near seeing a rebuilt Camelot.

For those with only human capital to play with, the situation is much the same, though the fear, the sense of fragility, is more directly centered in potential loss of social position. This is not surprising in a bourgeois, not an egalitarian, democracy. To be a renter again is psychically, as well as economically frightening. Security of social position in a stable economic structure is essential for working stiffs, of both collar colors.

The alternatives available to human capital when economic, and thus social, position is threatened, or only insecure, are three – earn-more and/or borrow-more and/or spend-less. As for the earn-more alternative, the growth of the two-wage-earner family speaks volumes. As for the borrow-more alternative the extraordinary increase in debt used to support personal consumption speaks equally loud. As for the spend-less side, I suspect that the choices are graded. Entertainment may well be the first to go. Next, food and clothing expenditures can be cut back a little; do it yourself, expanded a bit. Perhaps the thermostat can be set a bit lower in winter and higher in summer. Then there is the possibility of putting off the purchase of a new car for a few years after payments on the old one are made. However, a reduction in

mortgage payments is not exactly plausible. If not lower mortgage payments, what else might be reduced?

For a long time the answer of choice seems to have been governmental expenditures, which is to say taxes. It is important to remember that the first great pushback against taxes came in California. In 1978 Proposition 13 limited increases in real property taxes. The Great Inflation of the 1970s and early 1980s left many people, mostly late 1960s and early 1970s retirees in the Sunbelt, with homes that, because of the inflation in their value, bore increasingly higher property taxes, but whose owners had relatively fixed incomes.

In these years similar, though more limited, foul-tempered fights over school budgets occurred in my upper-middle class neighborhood too. So, it is important to remember that selling one's home in order either to pay real property taxes or to find a new house with reduced taxes is not really an option. One either ends up homeless, a brutal variety of social class demotion, or moves to a lesser neighborhood, a less brutal class demotion, but still painful.

When one combines the deep economic squeeze of white middle class families with the increase in single young men without the income to marry and single women who had learned the feminist lesson to beware of men with empty promises, the politics of social position can get ugly. Such humans, who utter the cry that America is no longer ours, see a growing immigrant population – legal and illegal – many of whom have modest professional incomes, an African-American population that is no longer at the bottom of the social pecking order and has secured a significant number of more than middle-class jobs and an increasingly out, successful gay and lesbian population. That those who feel that their birthright has been stolen have focused on rabid support for tax reduction, blind fury in opposition to what they see as new and increased taxes, and grossly partisan redistricting and voter limitation rather than on the use of large-caliber weapons, may suggest that they are entitled to more sympathy

than the liberal elite is used to accord them. At the least their politics should be easier to understand, if not to condone, a position that is not equally appropriate with respect to those who choose to hijack such anger and bewilderment for their own, more self-centered political purposes.

Now, I suppose that at this point some of my readers, if there are any left, will expect me to suggest exactly how to build a persistent market structure that that will be a new economy. Others will wish that I suggest a theory that can explain exactly what caused the American economy to come apart in the way that it did. I can offer neither such a prescription nor such a theory. I am an historian. Historians should not be confused with either visionaries or theoreticians and properly are chary of making strong statements about causation. However, in my self-limited role I can and will suggest that almost all of the current suggestions seem foolish.

Finance is not a plausible basis for an economy. Indeed, if recent events are at all representative, finance appears to be prone to bouts of systematic self-destruction. It is a public utility, probably best regulated as such, that moves value from one time period to another. And its appended bits of gambling are zero-sum games; the only profits of such go to the house. It is not a plausible rock on which to build the vast web of social relations that is a life. Similarly, a return to mass manufacturing to which a unionized labor force's salary scale might be appended an implausible objective. The decline in cost of ocean transport has simply wiped out any such a possibility. The alternative of radically increasing the number of cubicle warriors will require a genetic transformation in the distribution of *sitzfleisch* in the population that is likely to require more than several generations to accomplish. Likewise, remedies that rely on ever-increasing amounts of formal education, and so assume radical changes in the human genome, will only follow from the adoption of Lamarckian genetic theory.

On the other hand, suggestions that government is the problem, not the solution, are implausible. Law, for better or worse, structures markets. Taxation and regulation, the major activities of government, may be more or less appropriate to a time and place, but at the same time they act together with humans to create that time and place. So, the question of what government should do is the same at any point in time: What kind of time and place do citizens want?

The past fifty years of wild flailing on the part of the humans who experienced the disappearance of the Post-War Economy and its replacement by nothing at all suggests to me that what humans want is a broader and deeper middle class. Any view of what might be a new congenial spot for happy-ever-aftering that does not start from this objective ought to be treated with great suspicion. That is, unless, with a sadder, but wiser Arthur at the end of Act II, we also are willing to settle for singing “Don’t let it be forgot / That once there was a spot / For one brief shining moment / That was known as Camelot.”