AN ADAPTATION FROM *THE TROUBLE WITH BILLIONAIRES*

By Linda McQuaig and Neil Brooks

As income and wealth have become increasingly concentrated at the top in recent decades, North American society has become highly unequal. While this trend towards greater inequality is clearly evident in Canada, it has been most pronounced in the United States.

The level of inequality in North America today is extreme in comparison to most other countries in the advanced world. It is also acute by historical North American standards, following a period of relative equality in the postwar period from 1945 to 1980.

Today's extreme concentration of income and wealth at the top has many impacts on society. One that has not been fully explored is its impact on financial stability, and therefore on broader economic growth.

If we chart the share of income captured by the top one percent over time, we see two distinct mountain-like peaks, identifying two particular moments in time over the past century when the rich have pulled most clearly ahead of the pack: 1929 and 2008.

It is certainly interesting to note that these moments of greatest income concentration coincide with the two infamous Wall Street crashes. Indeed, even the extent of the U.S. income captured by the top one percent in the years 1929 and 2008 is virtually the same – 24 percent.[1] This suggests that it is worth considering the possibility that extreme income inequality was a significant factor in the two financial crashes.

Oddly, extreme income inequality has received little attention in the media debate about the factors that led to the 2008 crash. Of course, there has been plenty of discussion of the role of individual rich people – indeed, the widely-agreed-upon villains in this tale are all very rich. And there's been ample talk about the problem of "greed." But there has been little consideration, at least in the mainstream media, of whether the crash was related to the structural reality of the rich having an unusually large share of the national income.

The lack of focus on extreme income inequality is evident in an analysis done by the Congressional Research Service (CRS) in a 2009 report to Congress. In this broad overview of the media and academic literature about the causes of the crash, the CRS singled out 26 different causes of the crash, and also provided commentary and additional reading references for each one. All the familiar culprits are here, including the housing bubble, financial innovation, deregulatory legislation, excessive leverage, even "human frailty." However, nowhere among the supposedly exhaustive 26 causes is there any mention of income inequality, or the unusually large share of income going to the rich. The suggestion here is not that the CRS is suppressing anything. Rather, it simply reported to Congress the factors that are widely considered to be the main causes of the crash. In the popular debate, extreme income inequality does not figure.

But then, extreme inequality is largely unnoticed in the mainstream. It barely registers as an issue in the public debate. Its negative consequences go mostly unmentioned.

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There was more than the usual secrecy as Frank Vanderlip and Henry Davison arrived at the White House on a cool evening in the fall of 1911. The men were two of Wall Street's most senior figures, and their meeting with President William Howard Taft was to be strictly confidential. A conservative Republican, Taft was known to have close ties to members of America's economic elite. However, his advisors were constantly urging him to be careful not to appear too accommodating to the wealthy, so it was considered best that the public know nothing about this meeting. After all, Vanderlip and Davison were top officials in the nation's leading banks, and they were there representing two even more wealthy and powerful men: John D. Rockefeller and John Pierpont Morgan who not only controlled the banks but, between them, exercised control over just about every corner of the U.S. economy.

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On the agenda at that White House meeting was a matter of considerable concern to the banking interests of Rockefeller and Morgan: the Taft administration was on the verge of shutting down "bank securities affiliates." These were companies set up by banks to get around restrictions that barred banks from becoming involved in the risky business of trading in stocks and bonds. Taft's solicitor general, Frederick J. Lehmann, after a review by his department, had concluded that the affiliates clearly violated the nation's banking laws. Spotting the potential for these affiliates to become vehicles for dangerous speculative ventures, Lehmann had notified the banks that he was planning to shut them down.[2]

Lehmann's decision had come as a surprise to Rockefeller and Morgan, who were used to getting their way in political matters. When Taft had taken office in 1909, a top Morgan official had wired Morgan, then vacationing with a massive entourage in Egypt, to confirm that the new Taft Cabinet was in line with the recommendations made by the Morgan empire: "Franklin MacVeagh Chicago has been selected for Secretary of the Treasury. Wickersham will be Attorney General and other places are filled to our entire satisfaction."[3]

Now it seemed that one of those Cabinet members, Frederick Lehmann, had proved too zealous in pursuing his duties as solicitor general. The only remedy at this point was to appeal to the President himself. Certainly Taft was someone they presumed they could prevail with. They were aware that Taft was sensitive about appearing too close to the powerful – something even his wife advised him against. So while Taft golfed with the mighty industrialist Henry Clay Frick, he drew the line at golfing with the even more influential oil magnate John D. Rockefeller. Similar discretion was required in his dealing with banking colossus J. P. Morgan, who on a number of occasions quietly visited Taft's summer home, Beverly, without the visits becoming public. Taft's prudence in these matters was understandable. The public was agitated about the extraordinary clout wielded by these titans, and Taft felt it necessary to at least appear intent on breaking up their giant monopolies or "trusts," just as his popular predecessor, Theodore Roosevelt, had been. As with Roosevelt, there was a lot of anti-trust talk and some anti-trust action during the Taft administration, but also a lot of accommodating the business elite.

Certainly Taft had a freer hand to accommodate members of the elite when the issues were less in the public eye, as in the case of this "bank securities affiliates" matter. While the issue of trusts was highly controversial, much talked about in Congress and the press, the issue of bank affiliates was really on nobody's mind, except the bankers'. So when Taft met at the White House with Vanderlip, president of the Rockefeller-controlled National City Bank, and Davison, a high-ranking partner in J. P. Morgan & Company, the President knew he had some leeway. If he were to acquiesce to their demands, the public would not have to know. He did not need to fear that loudmouths like Congressman Charles A. Lindbergh (father of the famed future aviator) would have another opportunity to denounce the "Money Trust" as the most sinister power of all, or that muckraking journalist Lincoln Steffens would spot another chance to decry Pierpont Morgan as "the boss of the United States." No, what happened at this meeting – even the fact that it ever took place – would never have to go beyond those walls.

And so it was that the stout, mustached Taft, all 300 pounds of him, settled comfortably into a large sturdy chair. In the comfortable secrecy of the White House, he assured Vanderlip and Davison that he would overrule his own solicitor general, thereby handing his guests, and beyond them the potentates for whom this bone was really intended, the power to wreak havoc in the financial markets for almost two decades.

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In many ways, the seeds of the 1929 Wall Street crash were sown in that quiet White House meeting. What the President agreed to – in overruling his prescient solicitor general – amounted to a significant deregulation of the financial markets. The restrictions that kept banks out of trading in stocks and bonds had been a crucial pillar of the post-Civil War banking system. Given their important role in handling the savings of the public, banks had been considered too central to the economy to be allowed to play in the notoriously fast and loose trading world, which more closely resembled the world of gambling. Taft's decision to allow banks into this lucrative area essentially eliminated a deliberate safeguard that had been built into the 1864 U.S. National Bank Act, which had been modeled on English banking practices.

Not only did Taft's decision free up banks to use their vast deposits in risky ways, but it allowed the banks to raise even more money from members of the public by selling them stocks and bonds. Indeed, ordinary citizens were much more likely to trust a securities firm connected to a well-established bank than a lesser-known player in the securities field – a field which was known to be full of shady characters. This greater public confidence in the banks, which turned out to be undeserved, helped draw many unsophisticated investors into the financial marketplace, fuelling what became a gigantic speculative bubble in the late 1920s.

It is important to note that this key act – Taft's willingness to allow banks to stray into speculative territory – came about because of the immense political power of the wealthy financial elite. That Rockefeller and Morgan were able to get the President to agree not to enforce the nation's banking laws was a reflection of the extent to which control over the nation's wealth had become highly concentrated in a very small number of hands.

The nation of small yeoman farmers that had existed in colonial times and that the founding fathers had envisioned as a permanent feature of American democracy had largely disappeared by the early decades of the 1900s. Instead, the United States had become a highly stratified, top-heavy society dominated by a few dozen incredibly wealthy "robber barons." Ferdinand Lundberg captured the extent of the economic concentration that prevailed in the early years of the twentieth century in the title of his book that describes the phenomenon: *America's 60 Families* (1937). It was an age of stunning, conspicuous inequality, with grand, ornate mansions rising along Fifth Avenue, and the ultra-wealthy occupying a world of their own, whiling away their time in luxuriant splendour on sprawling country estates, waited on by legions of servants, or congregating for glittering costume balls at the glamorous Waldorf Astoria Hotel.

Part and parcel of this concentration of wealth was the emergence of a dominant banking elite, personified by the rise of J. P. Morgan. The son of a banker who had made a fortune raising British capital for American industrial expansion, J. P. Morgan ended up becoming America's richest and most powerful banker. An intense and domineering man who barked orders at underlings and vacationed with members of the British royal family, Morgan became a symbol of the growing concentration of money and power in banking. Morgan's reach extended far beyond what he actually owned. Through dominant positions on boards and executive committees, he and his close associates eventually controlled some 35 banks and insurance companies and 60 non-financial institutions, including such diverse corporate giants as United States Steel Corporation, American Telephone and Telegraph, the Chesapeake and Ohio Railroad, General Electric Company, the International Harvester Company, Consolidated Edison Company, the Niagara Hudson Power Corporation, Standard Brands Incorporated and the United Gas Improvement Company of Philadelphia. In all, Morgan effectively controlled companies worth a total of $17 billion (equivalent to about $370 billion today). There were dozens more financial and non-financial entities in which Morgan was a dominant influence, even without holding direct control. Biographer Anna Rochester compared the sprawling empire of Morgan to a medieval fortress whose "inner stronghold is surrounded by open stretches on which maneuvers can take place only with the knowledge and goodwill of the ruling lord."[4]

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Indeed, Morgan had all the imperiousness of a medieval lord. In open defiance of the nation's anti-trust laws, he and Rockefeller had brazenly created a giant holding company that knit together Morgan and Rockefeller interests, raising fears that the entire American economy could end up under the control of one company. When Theodore Roosevelt's administration initiated an anti-trust action against the holding company in 1902, Morgan was highly annoyed, telling guests at a dinner party he had been assured that the new president, for all his trust-busting talk, would do the "gentlemanly thing." Morgan appears to have regarded the anti-trust action almost as a matter to be sorted out privately by two equally powerful potentates. Meeting with Roosevelt at the White House, Morgan reportedly told the President: "If we have done anything wrong, send your man to my man and they can fix it up." Although the anti-trust case did proceed (and eventually resulted in the dissolution of the holding company), Morgan was assured by the President at the White House meeting that Morgan's many other monopoly interests were safe from government intervention.

Along with Morgan, two other banking interests had come to dominate Wall Street early in the twentieth century – National City Bank, controlled by Rockefeller (with J. P. Morgan being the second largest stockholder), and First National Bank of New York, controlled by financier George F. Baker, who was ranked the eleventh richest man in the country. Concern over the influence of these three enormously potent banking interests prompted a 1912 Congressional investigation. Led by Democratic Congressman Arsène Pujo of Louisiana, the lengthy probe documented the extraordinary financial reach of this banking triumvirate: together, their principals held 341 directorships in 112 corporations, with aggregate resources or capitalization of $22 billion. This gave this inner circle of Wall Street interests a degree of control over the economy that was shocking even to an American public that had become used to the power wielded by the big industrial monopolies of the time – the oil trust, the railroad trust, the steel trust, the copper trust, the sugar trust, etc. The Pujo Committee charged that, of all the trusts, this one – "the Money Trust" – was the most threatening to the public welfare: "Far more dangerous than all that has happened to us in the past in the way of elimination of competition in industry is the control of credit through the domination of these groups over our banks and industries."

The clout of the House of Morgan was perhaps most nakedly displayed in the infamous "Bankers' Panic" of 1907. After a series of moves that suggest Morgan may have deliberately created a panic in the markets, President Theodore Roosevelt put $25 million in Treasury funds under the control of J. P. Morgan & Company, hoping that Morgan would use it to calm the markets down.

When the market tumult continued, Roosevelt realized Morgan wanted more from the White House, particularly in connection with Morgan's interest in having U.S. Steel absorb Tennessee Coal and Iron – a takeover which would amount to a serious violation of the Sherman Anti-Trust Act. As the Wall Street panic grew, the President met with high-level Morgan emissaries at the White House and assured them his administration would take no action in the event of a Tennessee Coal takeover. After that, calm was very quickly restored to the markets, for which Morgan was widely credited. Roosevelt delivered on his end of the implicit deal as well; U.S. Steel was permitted to take over Tennessee Coal while frustrated government anti-trust lawyers were obliged to look the other way.[6]

In the wake of the Bankers' Panic, the power of the moneyed interests had become so flagrant that there were widespread calls for something to be done. Congress set up a commission to consider banking reforms – only to have Morgan interests quickly capture control of it. Indeed, from the outset, the commission was effectively under the thumb of the House of Morgan. It was chaired by Republican Senator Nelson Aldrich, a wealthy Rhode Island financier who moved in elite business and social circles, and whose daughter Abby married John D. Rockefeller, Jr. As a senator, Aldrich was known for his vigorous championing of the cause of the wealthy, and he immediately appointed Henry P. Davison, a trusted Morgan associate, as his advisor on the banking commission. (Davison was the banker who would later represent Morgan in the 1911 meeting with Taft at the White House.) This meant that Davison would have ample opportunity to influence the Aldrich Commission in the direction favoured by Morgan and the Wall Street clique – a clique that Aldrich was already closely allied to. As a cable sent to Pierpont Morgan from a Morgan official noted: "It is understood that Davison is to represent our views and will be particularly close to Senator Aldrich."[7]

The key reform to be considered by the Aldrich Commission was the creation of a central bank. The House of Morgan had effectively been operating as one, but it was now widely appreciated that this gave Morgan far too much power over the U.S. economy. The important question for the commission was what form a U.S. central bank would take. Should it be under the control of private interests, similar to the Bank of England, or under government control? Some reformers, notably the farmer-dominated Populist movement, were not keen on a central bank at all, fearing it would end up dominated by Wall Street, no matter who technically ran it.

Among the small group of insiders with input into the Aldrich Commission, the matter was never in doubt. In 1910, Senator Aldrich, along with his close advisor Henry Davison and a small cabal of Wall Street bankers, departed for a secret retreat at the Jekyll Island Club, a favourite Morgan hideaway off the cost of Georgia. There, in secluded splendour, ostensibly on a duck-hunting vacation, they devised a plan for a fully private central bank, involving a system of private regional reserve banks to be governed by a board of private bankers.

When Aldrich presented a bill for a central bank along these lines, it was widely denounced as a Wall Street scheme and blocked by Democrats in Congress. Several years later, the Democrats brought forward legislation for the Federal Reserve System, a central banking system modeled along the lines of the Jekyll Island plan, but with the modification that the private regional banks be placed under the authority of a government-appointed board based in Washington. Although the creation of the Federal Reserve System in 1913 was aimed at limiting Wall Street's power, in reality, things turned out much as the Populists had predicted. Despite the government board at the top, the New York Reserve Bank dominated the system, largely determining the nation's monetary policy to suit Wall Street interests. Benjamin Strong, who served for many years as governor of the New York Reserve Bank, was a Wall Street banker who had in fact been part of the Jekyll Island cabal. Author Ron Chernow argues that, far from seeing its power diminished, the House of Morgan was able to "skillfully harness the Fed and use it to amplify its powers."[8]

By the 1920s, the power of the financial elite had become even more entrenched than it had been in the preceding decades. Labour and agrarian protest movements which had sprung up in the late 19th and early 20th century had largely petered out as a significant force in American politics. Their leader, William Jennings Bryan, had proved unable to make a breakthrough as a presidential candidate for either the Democratic or Populist parties. By 1924, the badly divided Democrats abandoned any pretense of being a reform-oriented party and, on the 103rd ballot at their convention, selected as their leader John W. Davis – a senior attorney for J. P. Morgan.[9] Meanwhile, in the Republican Party, wealthy interests unabashedly dominated. As Lundberg wryly noted, the contest between Herbert Hoover and Andrew Mellon for the 1928 Republican presidential nomination "was strictly one between Morgan finance capital and Mellon finance capital."[10] Indeed, without pressure from the left, the Republicans happily drifted even further to the right.

After two decades of feeling the need to at least appear concerned about the problems posed by the giant monopolies, the three Republican presidents who held office in the 1920s – Warren Harding, Calvin Coolidge and Herbert Hoover – settled into the comfortable niche of simply accommodating the interests of the wealthy.

Nowhere was this more evident than in the area of tax policy. Arguably more important than the rather lackluster Republican presidents themselves was Andrew Mellon, a wealthy Pittsburgh banker who served as Treasury secretary in all three Republican administrations of the 1920s, and whose extensive financial and business holdings made him the fifth richest man in the nation. Mellon used his position and personal influence to work tirelessly to reduce taxes on the well-to-do. Although opposition from progressives in Congress thwarted some of his early attempts, Mellon succeeded in pushing through a 1926 revenue bill that dramatically cut taxes on the rich. Under the Mellon bill, someone earning $1 million a year saw his tax bill plummet from $600,000 to $200,000. Mellon also brought down taxes on estates to a maximum of 20 percent, a rate which kicked in only on estates above $10 million (equivalent to $121 million today).[12]

Not content to massively reduce their taxes in the present and the future, Mellon reached back into the past as well, quietly signaling to wealthy taxpayers (particularly Republican friends) that the Treasury department would happily review any requests they might have for reductions in their taxes going back to 1917. (It was Mellon's view that the rich had paid too much tax on the enormous wartime profits they had made during World War I.) Not surprisingly, wealthy people and corporations responded keenly to the offer, and before long there were some 27,000 lawyers and accountants presenting tax rebate cases to the Treasury.[13]

Under Mellon's guiding hand, the Treasury proved very accommodating to the desires of the rich to get back whatever financial contribution they had made to the war effort. The list of tax refunds eventually totaled $1.27 billion and filled some twenty thousand pages. Incredibly, $7 million went to Mellon himself and $14 million to his corporate interests.[14] Altogether, with the reduced tax rates as well as the refunds, Mellon's Treasury department handed over an astonishing $6 billion to the wealthiest Americans (equivalent to $72 billion today), a massive windfall that was to act like gasoline in fueling the stock market bubble of the late 1920s.

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As the nation's elite devoured an ever-larger share of the national income, far below them, the vast majority of Americans lived extremely modest, austere lives with little political power. Unionization efforts had been fiercely opposed by the great industrial titans of the late 19th and early 20th centuries, with strikes ruthlessly suppressed, sometimes with state support. Workers returning from the battlefields of World War I came home to high unemployment and stagnant or falling wages. With union power on the decline, dissenters turned to radicalism and even anarchism, making it even easier for authorities to vilify and clamp down on labour.

So, although the 1920s proved to be a decade of significant technological advances, workers were in such a weak bargaining position they were unable to demand a meaningful share of the gains. From 1919 to 1929, worker output in manufacturing rose by a significant 43 percent, but wages rose by only 8 percent. With the costs of production falling and workers getting only a small share of the benefits, the gains of this improved productivity were flowing heavily into corporate coffers. As John Kenneth Galbraith noted, "The rich were getting richer faster than the poor were getting less poor."[15] This left vast segments of the working population unable to afford the amazing new consumer goods that the technological advances were making possible, notably cars, refrigerators, radios, and vacuum cleaners. The more prosperous sections of the middle class could only afford these luxuries by buying them on credit through popular new installment plans. With consumer demand constrained by the limited buying power of the masses, there was little incentive for corporations to invest their accumulating profits in expanding their factories. Those factories were already highly productive, efficiently producing as much as could be sold to a population whose appetite for the new consumer items was not matched by its ability to pay for them.

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This left corporations looking for other places to invest their surplus funds. Along with wealthy individuals, whose pockets were also bulging after Mellon's generous 1926 tax cut, corporations increasingly directed their funds towards Wall Street. Undoubtedly there was money to be made there. Corporate stocks, reflecting the substantial productivity gains, were rising impressively. For instance, stock in Radio Corporation of America (RCA) shot up from $85 to $420 a share in the course of 1928, feeding the notion that Wall Street was a place where money quickly multiplied. As more and more money flowed in, stock prices rose ever higher with seemingly unstoppable momentum.

The glittering lives of the very rich and the upward surge of the stock market set the tone for the era, creating the impression that getting rich quick was just another exciting aspect of the Roaring Twenties. Middle class Americans who had been weaned on ideologies of hard work, honest effort and doing without were suddenly mesmerized by the thought that, by investing just a little bit they too could get wildly rich. Speculation pushed up Florida land prices to feverish heights in the mid-1920s, with investors snapping up unseen swamp properties far from any beach – only to have the market come crashing down (in part because of a brutal 1926 hurricane). Undeterred by the sobering losses, the focus of the speculative fever simply moved elsewhere. Certainly Wall Street bankers were fanning the flames. The press, much of it owned by the fabulously wealthy Hearst and Pulitzer families, helped out with their own keen promotion of the wealth-making possibilities on Wall Street. Even the Democratic Party, having abandoned any pretense of being a promoter of progressive causes, pushed Wall Street schemes as the solution to the nation's problems. Writing in *Ladies' Home Journal* in 1929, Democratic national chairman and prominent financier John J. Raskob expressed the new zeitgeist of the party in an article full of investment tips, under the title: "Everybody Ought to be Rich."

It was an almost irresistible notion, made tantalizingly possible by Wall Street's offer of allowing investors to buy largely on credit. This was a variation of the installment plans being peddled to middle class consumers to help them afford cars and appliances. Just as they could put down a little money towards buying a car, Wall Street was inviting them to put down a little money towards getting very rich, offering to sell them stocks "on margin" for a fraction of the price. With just $10, it was possible to buy an $85 share in RCA at the beginning of 1928, with the remaining $75 provided by the Wall Street broker in the form of a loan. By the end of the year, the share was worth $420. So, after repaying the broker's loan with interest, the purchaser was left with a whopping profit of about $330 – all from a mere $10 down months earlier.

Variations of this sort of scheme were being keenly peddled by Wall Street. But while there were real opportunities to make a lot of money quickly, there were also tremendous risks. One obvious risk was that the stock price would fall, leaving the investor in considerable trouble. If he had put up $10 to buy the $85 RCA stock, and the stock fell to $60 by the end of the year (instead of rising to $420), he would lose his initial $10, and he would also owe another $15 (plus interest) to the broker for his loan.

However, this less attractive scenario was far from the minds of those playing in the giant gambling parlours of Wall Street. Indeed, as the market kept rising with more and more money flowing in, there was an eagerness to believe that this cornucopia was real and had only to be seized. And so caution was largely thrown to the wind. The miracle profits that were possible by buying on margin were only the beginning. These profits could be infinitely multiplied by adding on layer upon layer of investments – all bought on margin. This was accomplished through "investment trusts," paper companies that did nothing but hold stock in other companies. A purchaser could buy a share in an investment trust, which would then, on margin, buy stock in another investment trust, which would then, on margin, buy stock in yet another investment trust, and so on. A giant pyramid could be constructed in which very little actual money was ever put down by investors. As long as the stock prices kept rising, the profits simply multiplied. On the other hand, if prices were to collapse, the whole edifice would come tumbling down, and a great deal of money would be owed to those providing the loans.

The nation's leading banks, liberated by President Taft from their legal responsibility to avoid this world of gambling, had fully jumped in. Their presence only helped drive the frenzy. After all, the major Wall Street banks certainly seemed to know what they were doing. So, for instance, the public was inclined to trust the National City Company, a securities affiliate of the powerful National City Bank, which was controlled by Rockefeller with a major share held by J. P. Morgan. At the height of the boom, National City Company had some 1,900 salesmen out aggressively selling its financial products, including some highly risky Latin American loans that were offered to the public as largely risk-free bonds. Whereas potential investors would have likely been skeptical of bonds offered by unknown dealers from Brazil, Chile or Peru, they put aside such fears and eagerly bought up the near-worthless bonds when they were offered by an affiliate of the prestigious National City Bank with its top-drawer Wall Street pedigree.

The banks were only too pleased to take advantage of such trusting naivety, selling shares in investment trusts to the investing public at greatly inflated prices. In 1927, the public bought more than $400 million worth of stock in investment trusts. By 1929, that number rose to $3 billion. The ultimate scam, launched in the final stretch of market frenzy leading up to the crash, involved a Morgan-sponsored investment trust known as Alleghany Corporation selling shares in a holding company that went on a massive binge of railroad and real estate takeovers.[16] The company created a giant pyramid scheme in which each new purchase was used as collateral for the next. The scam was made all the more curious by the fact that the holding company was managed by two Cleveland real estate brokers, Otis and Mantis Van Sweringen – strange, inseparable brothers who lived in a sprawling empty mansion where they slept in the same bedroom. The brothers ended up as figureheads of a giant railway conglomerate worth $3 billion. In fact, the real ownership was J. P. Morgan & Co., which, it was later revealed, had cheated investing members of the public out of $16 million. Meanwhile, a select group of Morgan associates and friends had been allowed to buy shares at a heavily discounted advance price, providing these insiders with instant windfalls when the shares were offered to the public. Among those who cashed in on such windfalls as part of the Morgan "preferred list" were a host of political figures from both political parties, including just-retired president, Calvin Coolidge.

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As the stock market rose to dizzying heights, funds flowed in from around the U.S. and even from around the world. All this had a choking effect on the "real" economy, as money was sucked from corporate coffers and the bank accounts of the wealthy into the speculative bubble. Much of the money loaned to investors for essentially gambling purposes actually came from the treasuries of major corporations. By late 1928, as the Fed pushed up interest rates in a belated attempt to cool the dangerously overheated market, the going rate for these loans to the "call market" shot up to 12 percent, a rate of return which was almost impossible to achieve by investing in the actual production of goods, but which speculators, anticipating mammoth returns, were willing to pay. By 1929, many of the leading corporations, including Standard Oil, Bethlehem Steel, United Gas and Improvement Company, General Foods, General Motors, Chrysler Corporation, had made multi-million dollar loans in the "call market," seeing that as the most profitable place to put their money. The involvement of such major companies in the Wall Street markets was unprecedented.[17]

The relationship between the financial world and the broader economy had been turned upside down. No longer was there any notion that the financial community was performing the useful function of acting as the brains of the economy, directing capital to where it could be most productively employed, and helping spread risk in the process. Rather the financial markets were sucking money directly out of productive places and feeding it into a giant speculative bubble – a bubble that would eventually break, with devastating repercussions for the whole economy.

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When a sweet-looking 32-year-old female little person crawled into the lap of banking magnate Jack Morgan, the 1933 Senate hearings into the banking disasters of the previous decade did, almost literally, turn into a circus. Jack Morgan was not quite the legendary character his father had been but, as head of the sprawling financial empire pioneered by his father, Jack had emerged as a famous and feared Wall Street titan in his own right. Indeed, he was J. P. Morgan, just as his father had been, providing a continuity that helped perpetuate the dominance of the Morgan dynasty. So the stunt, dreamt up by newsmen covering the hearings to provide them with a dramatic photo, caught the reserved, late-middle-aged Jack Morgan completely off guard and somewhat flustered. As the professional circus performer planted herself firmly on his knee, photographers got their dream photo, and the broader public saw for the first time a scene in which the usually imposing and haughty head of the House of Morgan was no longer calling the shots.

In many ways, the moment dramatically captured a power shift that was underway in America, as the head of the most powerful set of money interests was being forced to submit to something almost completely unfamiliar to him: public authority. The 1929 Wall Street crash and the painful downturn that followed had fundamentally altered the political landscape of America. By 1933, there were 13 million unemployed (about 25 percent of the labour force), with thousands of homeless men riding the rails searching for work. The enraged American public was not only hungry for food, but also hungry for answers as to what had gone so terribly wrong.

The bank hearings, right after the administration of Franklin D. Roosevelt took office, served up to angry citizens the villains they were looking for. Conducted by a tough, uncompromising former New York assistant attorney general named Ferdinand Pecora, the hearings pried open the scheming world of Wall Street banking. Even the grand, graciously-chandeliered House of Morgan at Wall and Broad Streets was obliged to open its doors to Pecora's inquisitive agents, giving the public its first real look inside the highly secretive world. With the public intently following the hearings, which were covered in salacious detail by the scandal-mongering press, Pecora unveiled just how elitist these aristocratic banks truly were. They did not handle just anybody's money, but rather regarded a Morgan account as a privilege they bestowed on those inside their social circle. Duncan Fletcher, the powerful chairman of the Senate Banking and Currency Committee under whose auspices the hearings were being held, prodded Morgan with questions about his bank's aloofness. Morgan simply confirmed that, no, the bank would not accept deposits from strangers. Frustrated, Fletcher pressed on: "I suppose if I went there, even though I had never [seen] any member of the firm, and had $100,000 I wanted to leave with the bank, you would take it, wouldn't you?" "No we should not do it," Morgan calmly replied. "Not unless you came in with some introduction, Senator."[18]

Public rage grew as the hearings wore on. The unrelenting, cigar-smoking Pecora unearthed the fact that President Taft had met secretly with the Rockefeller and Morgan representatives in 1911, and promised them he would not enforce the ban on bank securities affiliates. There were revelations that the banks, through these securities affiliates, had been involved in more than four hundred stock pools – syndicates that actively manipulated stock prices, often with the help of publicity agents or even financial reporters taking bribes. Perhaps the most egregious fact unveiled by the relentless Pecora hearings was that Jack Morgan, who in the midst of the Depression still took home a princely salary of $5 million a year, lived on a lush, 250-acre island estate and sailed on the world's most elaborate yacht – had paid absolutely no U.S. income tax in 1930, 1931 or 1932. (For that matter, none of the twenty wealthy Morgan partners had seen the need to pay any income taxes in 1931 or 1932.) With so many Americans destitute, this was the final straw. With headlines about "tax evasion" trumpeted across the country the next day, the stage was set for a historic move aimed at bringing Wall Street to heel.

Barely a month later, in June 1933, a bill that had been working its way through Congress was signed into law by President Roosevelt. Known as the Glass-Steagall Act, after sponsors Senator Carter Glass and Representative Henry Steagall, the legislation restored the safeguard that President Taft had so cavalierly allowed to be tossed aside in 1911. Banks were once again to be kept out of the volatile, speculative arena of stock trading. A strict wall of division was erected to separate investment houses from commercial banks, which handled the savings of the public. The move was fiercely protested by Wall Street. But this time, with an irate public watching closely, the bankers were not able to prevail. Roosevelt, despite a wealthy pedigree (and past employment at a Wall Street firm), did not capitulate.

Indeed, the following year, Roosevelt angered Wall Street further by appointing maverick Utah banker Mariner Eccles to be chairman of the Federal Reserve. Eccles believed in Keynesian-style economic stimulus as a cure to the Depression – an approach that was anathema to conservative Wall Street bankers, but that won favour with Roosevelt. Worse still from Wall Street's point of view, Eccles encouraged an overhaul of the Federal Reserve Act that transferred power from the New York Fed to the Federal Reserve Board in Washington, stripping Wall Street of its effective control over the nation's central bank. The best-laid plans of the Jekyll Island banking clique lay in ruins. Wall Street had been reduced to a faint shadow of its former self.

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The humbling of Wall Street in the 1930s was a key part of the sweeping changes that significantly reduced the power and wealth of the very rich in the decades that followed. As a result, the United States became a considerably more egalitarian society dominated by a large, thriving middle class.

Of course, many racial, ethnic and gender prejudices remained, blocking a number of groups, notably blacks and women, from sharing fully in the move towards economic equality. Still, overall, the change from the pre-1929 Gilded Age was striking, remaking America in ways that would have been barely imaginable a few decades earlier. As Nobel Prize-winning economist Paul Krugman has noted, the rise of a significant middle class in these postwar decades was not a gradual process that evolved due to market forces, but rather a sudden development that had more to do with the changing balance of power. Widespread anger at Wall Street for bringing on the Depression had brought an end to public resignation about the privileges of the rich. There was now a determination that wealth and power should be more broadly shared with the rest of society.

The once-cosy relationship between Wall Street and the White House had been severely strained, as the Roosevelt administration now promised a "New Deal" that would include ordinary Americans. At a speech at Madison Square Gardens in 1936, President Roosevelt unabashedly expressed antagonism towards the wealthy interests that had brought chaos to Wall Street: "Never before in our history have these forces been so united against one candidate as they stand today. They are unanimous in their hate for me – and I welcome their hatred." His Secretary of the Interior, Harold Ickes, described America as locked in a struggle between the power of money and the power of the democratic instinct: "[T]his irreconcilable conflict, long growing in our history, has come into the open as never before, has taken on a form and an intensity which makes it clear that it must be fought through to a finish—until plutocracy or democracy—until America's sixty families or America's 120 million people win." [20]

With strong public backing, the Roosevelt administration took steps that greatly strengthened the hand of organized labour, bringing an end to the days when government automatically sided with the corporate elite. FDR signaled the beginning of a new labour-friendly era in 1935 by signing the Fair Labour Relations Act, a far-reaching bill aimed at ensuring workers the right to organize and bargain collectively, and giving government a role in enforcing those rights. During World War II, FDR used the sweeping powers of the National War Labor Board to raise wages in a range of industries, particularly the wages of the lowest-paid workers. With government actively backing unions and pushing up wages, unionization increased dramatically, almost tripling from 12 percent of the workforce in 1935 to 35 percent a decade later.

WIDESPREAD ANGER AT WALL STREET FOR BRINGING ON THE DEPRESSION HAD BROUGHT AN END TO PUBLIC RESIGNATION ABOUT THE PRIVILEGES OF THE RICH.

In the new climate, unions flourished, winning deals at the bargaining table from employers who now saw co-operation with their workforces as the sensible approach. In a precedent-setting 1949 deal dubbed the Treaty of Detroit, the United Auto Workers (UAW) and General Motors agreed to labour peace in exchange for workers receiving wage hikes and benefits in line with productivity gains. The deal set the tone for labour relations in the postwar years, allowing the gains of the UAW to push up wages across the economy. Among other things, this meant that workers came to form a vast consumer block with considerable buying power. As a result, corporations had plenty of incentive to invest in making products to sell to these eager consumers, rather than directing corporate capital to the speculative dens of Wall Street.

As the middle class became more prosperous, there was a relative decline in the fortunes of the rich. Indeed, as mentioned, the share of national income going to the top one percent fell from 24 percent down to about 10 percent. To some extent, the rich had lost ground as a result of the financial cataclysm of 1929 and the severe downturn that followed. However, even when the rest of the economy bounced back robustly after 1945, the rich did not recover their former predominance. As economists Thomas Piketty and Emmanuel Saez have shown, the declining fortunes of the wealthy were due in part to government action.[21] Among other things, Washington dramatically increased taxes on the rich.

In the 1920s heyday of pro-rich tax policies under Andrew Mellon, the top marginal tax rate had been only 24 percent. However, Roosevelt pushed up that top rate to 63 percent, and then to 79 percent. As this more egalitarian ideal became the established norm in the postwar years, successive governments – even Republican ones – followed suit. Under the Eisenhower administration, the top marginal rate rose to a striking 91 percent. (Some commentators try to dismiss the significance of these high rates, suggesting that loopholes allowed the rich to avoid paying them. While the rich certainly did take advantage of loopholes, the simple truth is that, in the postwar era, the rich paid a significantly larger share of their incomes in tax than they did in earlier times, or than they do today.) Estate taxes followed a similar pattern, with the top rate rising from 20 percent in the 1920s to 77 percent in the 1950s, making it more difficult for the ultra-wealthy to perpetuate family dynasties. There were still rich people who lived very comfortable lives, but the super rich, the ones living fairy tale lives in sumptuous estates groomed by armies of servants, were increasingly relics of bygone days.

The overall result was a more egalitarian society, as the wage increases of working people and heavier taxation of the rich led to a far greater equality in income distribution. The egalitarian reality also contributed to a new ethos of equality, fairness and public empowerment. This was reflected in support for government, which was called upon to defend and promote the public interest. No longer regarded as simply an instrument for protecting the interests of a small wealthy class with which it had been so closely allied, government was now seen as an institution with a duty to represent the interests of the population at large. And, having proved itself capable and effective in defending the population in fighting the war and pulling the country out of depression, government came to enjoy respect as a central and beneficial force in society.

The very notion that there was a public interest, and that government had an obligation to serve it, was part of a profound change in public attitudes. Among other things, the new attitudes removed the well-to-do from their protected bubble at the top of society and brought them more into the mainstream. No longer giants who strode unchallenged across the economic skyscape, the wealthy had been brought closer to the ground. They were now subject to economic as well as social constraints, facing greater regulation in their business affairs, heavier taxation of their incomes and public disdain for behaviour that seemed excessively self-interested or greedy. Under the new social contract, everyone was expected to contribute to the community. Pierpont Morgan had once famously said: "I owe the public nothing."[22] In the egalitarian heyday of the early postwar years, the self-centred Morgan would have been regarded as the crassest of boors.

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The new era cast a pall over Wall Street. In line with the Glass-Steagall Act, commercial banks were now required to divest themselves of their lucrative investment divisions, which were sold as separate investment banks. The idea was that commercial banks, which received deposits from the public, were to be subject to a tight new set of regulations. In exchange, they were to be protected from bank failure by government, which would provide insurance covering deposits so that members of the public would not rush to pull their money out in the case of a financial panic. Thus there was a trade-off for the commercial banks: although they were now subjected to strict regulation, they got the full protection of government, ensuring they would not fail. Commercial banks were also prevented from holding significant equity stakes in companies. Along with these new restrictions, high estate taxes were clipping the wings of the favoured clientele of the banking elite. As Ron Chernow observes, "the glue that compressed companies, banks, and rich families into a coherent financial class was coming unstuck."[23]

For those who had enjoyed great clout, the restrictions no doubt felt like a blow. Although for all the bemoaning and the vilification of FDR as an enemy of his class, the big Wall Street banks and investment houses continued to function and even thrive. What had changed was that they were now carrying out the function they were supposed to perform: raising and allocating capital so that the economy could operate efficiently. Indeed, as Chernow notes, investment banks in the postwar era "functioned according to a textbook model in which capital was tapped for investment, not financial manipulation."

The result was an era of remarkable financial stability, with the lowest level of bank failure in American history.[24] Throughout the decade of the 1970s, only 79 banks failed – compared to 2,000 during the seven-year period between 1985 and 1992.[25] Indeed, banking was transformed into a fairly dull, predictable enterprise. "Postwar commercial banking became similar to a regulated utility, enjoying moderate profits with little risk and low competition," note Simon Johnson and James Kwak.[26] The lack of excitement in the banking world was captured in what became known in banking circles as the "3-6-3 rule": pay depositors 3 percent, make loans at 6 percent, and hit the golf course by 3 pm. (Recently, there has been a new appreciation in some circles for this postwar dullness. Following the wildly volatile events of September 2008, Mervyn King, governor of the Bank of England, urged a group of British bankers "to join me in promoting the idea that a little more boredom would be no bad thing. The long march back to boredom and stability starts tonight.")[27]

Certainly, in the postwar era, banking was no longer the hotbed of action it had been in the 1920s, luring talent from other fields. Doug Peters, who went on to become chief economist and senior vice-president of the Toronto Dominion Bank in the 1990s, recalls the sleepy nature of the banking world in the 1950s and 60s. Peters got his start in banking almost by accident, because as a young man he had been kicked out of university with a 40 percent average and was told by the government employment office in Winnipeg that "the only place for someone with no education and no skills is a bank." Peters got another shot at redeeming himself academically a couple of years later when he was accepted at Queen's University, and then soon thrown out for failing two courses. Once again, banking seemed the only option; this time he ended up as a loans officer at the Bank of Montreal.[28]

As merger mania spread through the corporate community, bankers were transported back to the world of the 1920s – playing lucrative self-enriching games with other people's assets, and shifting the risk onto others.

But while the financial world may have lacked glamour and drama in the early postwar years, bankers were performing their proper role as intermediaries, connecting capital to the real economy. As a result, U.S. industrial interests in automobiles, steel, aluminum and oil took over centre stage, providing the basis for a period of strong, sustained economic growth – and one in which labour was allowed to share.[29]

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On Wall Street, the yearning for the old days remained alive, and there were always those who wanted to unravel the postwar deal. With the rise of less regulated financial markets in Europe (Euromarkets) in the early 1960s, there was increasing resentment in New York towards the restrictions imposed by the Glass-Steagall Act. By investing in these overseas markets, banks got a taste of being able to operate freely again, tossing aside bothersome New Deal rules requiring them to hold mandatory reserves and pay deposit insurance premiums.

The appetite for such freedom only grew as time went on, particularly with the innovation of leveraged buy-outs (LBOs) in the 1980s. A throwback to the pyramid-style holding companies championed by J. P. Morgan & Company in the 1920s, LBOs made Wall Street bankers key players in corporate takeovers. Typically, bankers would provide funding to a company's management team and a group of outside investors who were trying to take control of the company, using the company's own assets as collateral for the loans. The deals were incredibly dangerous to the health of the targeted company, which would be left holding high levels of debt after the takeover, but not very risky for the bankers and its takeover partners, who put up only a small part of the money. As merger mania spread through the corporate community, bankers were transported back to the world of the 1920s – playing lucrative self-enriching games with other people's assets, and shifting the risk onto others.

Meanwhile, the emergence of the new discipline of academic finance seemed to provide an intellectual basis for a return to a more free-wheeling financial era. Economists and finance professors at the leading universities started developing complex new financial innovations, using high-yield debt, securitization, arbitrage trading and derivatives, based on highly complex, sophisticated mathematical models that gave a scientific veneer to the old game of gambling. Out of this new discipline came the Efficient Market Hypothesis, which seemed to prove that markets are always right and that therefore there is little need for regulation. Those who mistrusted the new theories and products were dismissed as Luddites unable or unwilling to seize the exciting new wealth-making opportunities.

This blind faith in the market was highly reminiscent of the irrational Wall Street confidence of the late 1920s. But whether or not the dangers had been properly appreciated in the 1920s, they should have been clearly evident by the 1980s. A number of meticulous investigations – most notably those headed by Pujo and Pecora – left little doubt what the banking world would do if given the freedom to indulge in risky, unregulated behaviour. The need to hold the line would seem obvious, but the forces pushing to knock down the walls that penned in Wall Street had gained strength. Indeed, the re-emergence of an aggressive Wall Street was part of a broader resurgence of wealthy interests, made possible by the 1980 election of Ronald Reagan.

Although packaged to the public as a folksy, straight-talker, Reagan had elevated himself from B-level movie star status mostly on the basis of his Hollywood union-busting. His rise had been championed by business and conservative interests anxious to roll back the restraints and egalitarian policies of the postwar era. These wealthy interests had never given up resisting the New Deal. After failing dismally in their bid to put conservative extremist Barry Goldwater in office in 1964, they became more focused and better organized, bankrolling an array of Washington think tanks that aggressively attacked liberalism and promoted ideologies favouring less regulation of business. They finally scored with Reagan, whose down-to-earth manner connected with voters. And Reagan delivered for them. From his early move to crush the air traffic controllers' strike to his massive tax cuts for the rich – reducing the top rate from 50 to 28 percent, Reagan's message of "morning again in America" was a sweet one for America's financial and corporate elite.

The Reagan era brought significant change to America, notably a dramatic rise in inequality and an ethos that supported this increased inequality. Indeed, it is hard to identify which came first, the inequality or the ethos that made the inequality palatable to the public. They clearly worked in tandem, reinforcing each other like a vicious circle. The more tax rates were cut and the rich became richer, the more money flooded into think tanks promoting the new conservative ideas, and the more the corporate-owned media felt comfortable promoting these ideas to the public. As the new conservatism took hold, creating a culture of rewarding "success," there was increased momentum for changes favouring corporate America and for still deeper tax cuts for the rich, leaving labour and ordinary working people ever more marginalized. The result was a significant decline in the clout and income of workers. The captains of the corporate world, empowered in the new environment, adopted a more adversarial approach towards organized labour and successfully pressured government to let labour protections lapse and the minimum wage languish. Consequently, unions were no longer able to ensure their members a share of productivity gains with positive ripple effects throughout the broad middle class. This in turn meant declining support for unions, which were no longer seen as key vehicles for advancing the interests of middle class workers.

As a result, there was virtually no growth in the real wages of American workers, even as incomes at the top soared. To the extent that the middle class was able to retain its buying power after 1980, it was due to the Federal Reserve's looser monetary policy, which kept real interest rates low and made borrowing more affordable. However, easier credit simply encouraged the middle class to become deeper and deeper in debt, with many living on their credit cards or borrowing against the equity in their homes. All this made ordinary Americans particularly vulnerable in the event of a serious downturn. It also meant that there was little incentive for corporations to invest in products to sell to middle class consumers, whose incomes were mostly stagnating.

The bleak prospects for the middle class were spelled out in a newsletter that Citibank sent out to its well-heeled clients in 2005. The newsletter noted that the U.S., Britain and Canada had become "plutonomies," economies where economic growth is largely restricted to the rich. The Citibank analysts who wrote the newsletter actually expressed surprise at their findings. They said that they had been shocked to discover the level of income concentration at the upper end, a level that they noted was matched by only a few other epochs in history (one of them being the Roaring Twenties in America). Their point was not to criticize or provoke controversy; and certainly not to suggest the need for any income redistribution. On the contrary, it was simply to advise their wealthy clients to focus their investment strategies on products catering to the rich – the only place the Citibank analysts foresaw substantial growth. (One of the analysts, Ajay Kapur, later left Citibank in order to start his own hedge fund.)[30]

Of course, the rich, even though they take consumption very seriously, can only consume so much. Even if they have ten or twenty cars per family – or similar numbers of high-end barbecues, walk-in refrigerators or massive flat-screen TVs in their multiple homes – there simply are not enough wealthy families to keep up consumer demand. With limited prospects for consumer spending among the masses, U.S. business responded by ceasing to invest in its own expansion. James Livingston, a historian at Rutgers University, notes that through the years of George W. Bush's administration, business invested less than its retained earnings for a period of six years – the longest stretch since World War II.[31] Instead, as in the 1920s, the action drifted to Wall Street. Whereas the financial sector accounted for just 2 percent of the economy in the early postwar years, by 2006 it had grown to 8 percent. Similarly, while the financial sector attracted only 5 percent of Harvard undergraduates in the 1960s, it was attracting more than 20 percent of them by the mid-2000s.[32]

Wall Street was both the beneficiary of the new conservatism, and an active promoter of its agenda. With the wind at its back, Wall Street pushed more aggressively to dismantle the regulatory controls of the New Deal. Up until the Reagan years, banks had tried to undermine regulations essentially by ignoring them, carrying on banking activities not permitted by the regulations in the hope that regulators and Congress would turn a blind eye. But now the bankers felt emboldened to try to actually get the controls removed. Not surprisingly, the House of Morgan was in the forefront of the attack, laying out its case in 1984 in a pointed document called *Rethinking Glass-Steagall*.[33] A key player in the campaign was Alan Greenspan, then a Morgan director as well as the former chairman of Gerald Ford's Council of Economic Advisors (and later, of course, chairman of the Federal Reserve).

This was just the opening salvo of a massive and abundantly-funded campaign for financial deregulation that was to become part of the vicious circle favouring the wealthy. As the rich became richer, they became bolder and more confident in their demands, and put more and more money into achieving them. And as they won more tax reductions for themselves, they had yet more money to sink into lobbying and campaigning. Between 1998 and 2008, financial companies donated $1.7 billion to federal political campaigns, and spent another $3.4 billion on lobbyists. That is almost $5 billion in a financial industry war-chest dedicated to the goal of dismantling decades-old regulations aimed at protecting the public from manipulation and speculation by the financial industry.[34]

Emboldened by the new political environment, Wall Street became more flagrant in its violations of Glass-Steagall. In 1998, financial services giant Travelers Group bought out Citibank, creating a sprawling conglomerate combining banking and insurance and openly defying Glass-Steagall. The following year, Congress passed legislation, championed by then-Texas Senator Phil Gramm, to repeal key sections of Glass-Steagall, making the Citibank merger retroactively legal. Gramm followed up soon after with the Commodity Futures Modernization Act, which made it impossible to regulate the exploding and highly speculative market for the new craze: credit default swaps (CDS), which now, thanks to the repeal of Glass-Steagall, were being eagerly bought up by regular banks. The floodgates were open. Things had come full circle back to 1911, when Morgan and Rockefeller interests had managed, in one secret meeting with the President, to overturn longstanding rules barring banks from participating in high-risk ventures.

Deregulation mania raged for the next decade, liberating every corner of the U.S. financial industry from what were patently sensible regulations aimed at protecting the public from reckless bankers, speculators, hucksters and just the blind stupid greed of the herd on a rampage. The phenomenon cannot simply be chalked up to the alleged imperatives of globalization, or the existence of freer financial markets offshore. There were international efforts to reign in the financial anarchy, but instead of joining them – even taking a leadership role – the U.S. government actively resisted attempts to bring order and caution to the markets. When the European Union tried to bring the foreign operations of America's five big investment banks under stricter European regulations in 2004, the Bush administration helped ward off such interference, siding with the U.S. banks' request to leave them alone to decide how best to regulate their own risky behaviour.

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Indeed, with billions of dollars of deals being made daily on Wall Street, regulation largely disappeared. And so it was that AIG, a global insurance colossus holding insurance policies for millions of people and businesses, ended up regulated by the modestly-equipped Office of Thrift Supervision (OTS). (In a fit of deregulation mania, Congress had passed legislation that enabled certain kinds of companies to choose the inadequately-equipped OTS as their regulator.) It is a bit understated to note that the OTS was understaffed; its one insurance specialist, C. K. Lee, later acknowledged he had been wrong in assuming that AIG's $500 billion worth of credit default swaps, backed up by nothing of real value, were "fairly benign products."[35] Surveying the damage in March 2009, U.S. Treasury Secretary Tim Geithner observed that there had been a serious lack of "adult supervision."

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What Geithner did not point to – but that strikes us as key – was the role played by extreme inequality.

As in the 1920s, the enormous concentration of income and wealth after 1980 led to a stunning degree of power in the hands of the financial elite, and they used this power to, among other things, shape the financial landscape to suit their interests. As the rich have become richer in the past three decades, they have attained a virtual stranglehold over the domain most important to them: the financial sector. As Simon Johnson has noted, the rising wealth of the rich in America in the past twenty-five years has enabled them to consolidate political power, giving the United States not just the most advanced economy, military and technology in the world, but also "its most advanced oligarchy" – similar, it could be added, to the extraordinary power wielded by an equally rich financial elite in the early part of the last century.

This extraordinary political power attained by the rich in recent years has enabled them to effectively disable government when it comes to regulating financial markets. So when Brooksley Born, head of the U.S. Commodity Futures Trading Commission, tried in the late 1990s to bring greater oversight to the wildly gyrating derivatives market, she was stopped in her tracks. It was almost a foregone conclusion that her efforts would be defeated, since she was opposed by the three most powerful government officials in the financial domain: Treasury Secretary Robert E. Rubin, Securities and Exchange Commission Chairman Arthur Levitt, Jr. and Federal Reserve Chairman Alan Greenspan. Significantly, these men had all earned their wealth via Wall Street and all were dedicated to the Wall Street creed of deregulation. Indeed, as noted, Greenspan, in his days as a J. P. Morgan director, had played a pivotal early role in the campaign for the repeal of Glass-Steagall.

In fact, prodigies of Wall Street have effectively taken over government by being appointed to its top economic management positions. A virtual revolving door has come to operate between Wall Street and Washington's power corridors, with Goldman Sachs practically serving as a training school for those running the U.S. Treasury. Robert Rubin spent 26 years at Goldman Sachs, rising to co-chairman of the firm before becoming Treasury secretary under Bill Clinton; Henry Paulson, a one-time Goldman CEO, became George W. Bush's Treasury secretary. Then there is Lawrence Summers, Barack Obama's top economic advisor, who earned $5.2 million in 2008 from hedge fund D. E. Shaw. Alan Greenspan left the Federal Reserve and became a financial consultant to Pimco, a key player in international bond markets. Given these interconnections, which are multiplied at lower levels as Wall Street titans bring their associates and bright underlings with them to fill positions throughout the Washington bureaucracy, it is not surprising that there is increasingly been a shared mindset and worldview, built around freeing up the market and loosening controls on financial capital. It is not hard to imagine how this nexus of power between Wall Street and Washington filtered down to encourage a "belief system," as Simon Johnson puts it, that gave Wall Street's power and influence a legitimacy throughout the broader culture.

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It has been said that much of the foolishness and excess on Wall Street in 2008 happened out of ignorance, that few players even understood the nature of the bets they were taking and the extent of the gambles they were making with other people's money and their own. However, that could never be said of Angelo Mozilo, the garrulous and cocky former CEO of Countrywide Financial Corporation – a company close to the centre of the financial crisis. Countrywide was one of the leading peddlers of subprime mortgages, offering the treacherous loans to thousands of Americans who, by any reasonable measure could not possibly make the payments they were signing up for. If Mozilo did not know the details of every case, he certainly knew the broad arc of the problem he was instrumental in creating. He knew that some of Countrywide's mortgages were, as he described them in internal emails, "poison," "toxic" or, not to put too fine a point on it, "the most dangerous product in existence."[36]

What makes the Mozilo story particularly interesting is not just his role so close to the epicenter of the meltdown, but his apparent reluctance to be there. In the early 1990s, Mozilo, perhaps heeding the wise counsel of his longtime business partner, David Loeb and perhaps his own inclinations, resisted the temptation to take Countrywide into the lucrative subprime market, steering sensibly clear of a product that was a danger to his company as well as homeowners who would soon be defaulting on their payments. But his resistance only lasted so long.

As the market heated up in the late 1990s, and his partner retired in 2000, Mozilo saw his chance to finally make it into the top banking circles he had always felt excluded from. Wall Street was hungry for the risky subprime mortgages, with their obscenely high interest rates that only clicked in after months of rock-bottom "teaser" rates, and that were only spelled out in very fine print. Mozilo moved aggressively into the subprime market, setting up a subsidiary specializing in them with thirty offices across the country and even cloaking the company's blatant opportunism in the mantle of social activism. "Homeownership is not a privilege but a right," he declared in a speech in Park City, Utah, as he now peddled "the most dangerous product in existence" to tens of thousands of unsuspecting, low-income folks. So, while Countrywide had insisted on 20 percent down on mortgages a few years earlier, it was now offering them for zero down – and to people who had no proof of having any sort of income. The full tragedy of situation – beyond the fact that people who could barely afford a trip to the laundromat were being lulled into believing they too could own a home of their own – was the fact that some borrowers with good credit ratings were redirected into the subprime market, where they ended up losing homes they could have afforded. This was done because it offered more profit for the likes of Mozilo and the Wall Street clan.

WHAT MAKES THE MOZILO STORY PARTICULARLY INTERESTING IS NOT JUST HIS ROLE SO CLOSE TO THE EPICENTER OF THE MELTDOWN, BUT HIS APPARENT RELUCTANCE TO BE THERE.

Countrywide became a stunning success story. By 2003, Mozilo had a personal compensation package of $33 million. He had more than realized his dreams of acceptance and achievement, being welcomed into the ranks of the big bankers. In 2005, Countrywide made it onto *Fortune's* list of "Most Admired Companies." Mozilo, whose Italian immigrant father had hoped his son would someday take over his butcher shop, was now being identified by *Barron's* as one of the thirty best CEOs in the world.

It is easy (and appropriate) to condemn Mozilo for his seemingly bottomless greed, but it might be more useful to try to understand him as a cultural phenomenon – a product of a culture (or even a cult) of greed in which, over the past few decades, the desire for material accumulation has been applauded, fanned and stimulated to an extraordinary extent. Wall Street has been the engine room of the cult, a kind of hot house of avarice, an experimental lab in which the normal restraining impulses, caution, prudence, common sense, not to mention common decency, were sliced and diced along with the toxic assets being peddling, and everyone was urged to join in a wild, rapturous romp towards snagging for oneself an ever-bigger pot of gold.

The ability to set cultural norms and attitudes is part of the power wielded by the dominant forces of society. So, in times of great wealth concentration, the financial elite not only politically captures control of the mechanisms of government, but also more broadly establishes the tone and defines the mores of the era. In both the pre-1929 period and in recent decades, a culture celebrating greed and wealth accumulation dominated, with notions about social responsibility and public spiritedness shunted to the sidelines, even sneered at as a kind of political correctness. Wall Street traders routinely boasted about "ripping the face off" clients, an expression that meant making profits by selling clients derivative deals so complicated they couldn't possibly understand them.[37] Such indifference to clients, let alone other members of the public, promoted an ethos in which greed and an obsessive focus on self-interest were considered normal and acceptable, even laudable and beneficial. It was this deadly combination – a political agenda controlled by the rich, reinforced by a culture celebrating greed and saluting billionaires – which allowed thousands of apparently normal people to take part in the subprime mortgage scam, either as participants preying on the vulnerable or as political authorities failing to stop the brazenly predatory behaviour.

It could be argued that, in a more egalitarian era, a different group, perhaps the middle class or, more specifically, organized labour, captures control of the political agenda and sets the tone of the times. There is some truth in this, although the amount of power wielded by labour at any point is generally exaggerated by conservative commentators. The notion of labour as a powerful "special interest" has been used to justify anti-union attacks in recent decades. In reality, workers are always at a disadvantage to corporate interests, which, by definition, have power over their employment. Even in the heyday of labour power in the early postwar decades, corporations remained enormously powerful, and there was considerable inequality. Back then, CEOs were not earning the massive incomes that they are today, but they were earning about thirty times what the average worker was earning, allowing them to enjoy substantially more comfortable lives. So, to the extent that labour wielded some power in the early postwar decades, this provided nothing more than a bit of healthy rebalancing, tipping the scales less overwhelmingly in favour of corporate interests, as had been the situation before 1929.

In any event, the point at issue here is the role extreme inequality played in the stock market crashes of 1929 and 2008.

As noted, income inequality has not generally been considered a factor in the 2008 crash. Nor has it attracted much attention as a factor leading to the 1929 crash and the Great Depression. Indeed, income inequality does not figure at all in the explanation of the Great Depression that has been most widely accepted in mainstream circles in recent years. The dominant explanation is the one put forward by Milton Friedman and Anna Jacobson Schwartz, who attached no particular significance to the rise of inequality. Instead, the Friedman-Schwartz thesis blames the Depression on inappropriate actions by the Federal Reserve, particularly the contraction of credit between 1930 and 1932, thereby turning what they believe would have been just another downturn in the business cycle into a full-fledged depression. This theory, embraced by current Federal Reserve chairman Ben Bernanke, considers management of the money supply the key to managing the economy and has led to the notion that the Fed can ward off depressions through sensible policies. As Bernanke, then a member of the Fed board, told the crowd at a 90th birthday party for Friedman in 2002: "I would like to say to Milton and Anna, regarding the Great Depression: You're right. We did it. We're very sorry. But thanks to you, we won't do it again." But the notion that things would have worked out fine back in the 1930s if only the Fed had properly managed the money supply seems less convincing in the wake of the 2008 Wall Street collapse, which happened despite the apparently greater sophistication of those running the Fed today, who had the benefit of hindsight. Rather, the striking similarity in the inequality levels in both 1929 and 2008, and the lack of financial crises in the more egalitarian postwar decades, seem to suggest a causal relationship between inequality and financial crashes. For that matter, while the Friedman-Schwartz thesis has become the dominant view in recent years, there have always been analysts who pointed to inequality as the key factor in the 1929 crash. In his book, *The Great Crash, 1929* (1961), economist John Kenneth Galbraith identified five factors he considered had a particular bearing on the 1929 disaster, with the first one being "The bad distribution of income." Historian Robert S. McElvaine agrees. "The causes of the Great Depression were many … In the end, though, the greatest weight must be assigned to the effects of an income distribution that was bad and getting worse," McElvaine wrote in *The Great Depression* (1984). "Maldistribution was only one among many roots of the Great Depression, *but it was the taproot* [italics added]." [38]

Recently, a number of analysts have also pointed to the significance of inequality as a factor in the 2008 crisis. "The real cause of the crisis," wrote World Bank economist Branko Milanovic in the spring of 2009, "is not to be found in hedge funds and bankers who simply behaved with the greed to which they are accustomed (and for which economists used to praise them). The real cause of the crisis lies in huge inequalities in income distribution which generated much larger investable funds than could be profitably employed." [39]

Historian James Livingston has also pointed to the similar patterns of extreme income concentration in the late 1920s and in the run-up to the 2008 collapse. Livingston, rejecting the Friedman-Schwartz thesis, argues that the "underlying cause" of the Great Depression "was not a short-term credit contraction engineered by central bankers … [but] a fundamental shift in income shares away from wages/consumption to corporate profits that produced a tidal wave of surplus capital that could not be profitably invested in goods production."[40] He notes that in the past twenty-five years there has been a similar shift away from wages and consumption, and towards corporate profits. For a while, government transfer payments offset wage stagnation, but this only delayed the gathering storm, according to Livingston. "The moment of truth reached in 1929 was accordingly postponed. But then George Bush's tax cuts produced a new tidal wave of surplus capital, with no place to go except real estate."

The evidence suggests that a high level of inequality sets up a dynamic that contributes to financial instability. Lack of buying power on the part of the mass of citizens leads to a lack of good investment opportunities in the real economy, driving capital towards the financial sector and concentrating wealth and power in the financial elite. This elite uses its clout to both create a social ethos that condones greed and to directly shape the political agenda to facilitate the amassing of great fortunes. A crucial element in this political agenda is the freeing up of financial markets for lucrative speculative activities. While the speculative activities are clearly orchestrated by the financial elite, segments of the broader public are drawn in, with most of the risks and the costs of a financial collapse ultimately borne by those outside the elite.

By contrast, when income is more widely dispersed, as in the early postwar era, there is strong consumer demand for goods and services, attracting capital into the real economy. With income more widely spread, political power is also more widely held. Middle class citizens and organized labour are not inclined to use their political clout to press for freer financial markets, but rather to protect and enhance their own incomes and buying power. This creates a political agenda and a social ethos that has a restraining effect on financial markets. As we have seen, Wall Street investment banking continued to function in the more egalitarian postwar era, but it did so, as Chernow notes "according to a textbook model, in which capital was tapped for investment, not financial manipulation." In other words, Wall Street functioned as it should – as a vehicle for raising and allocating capital for the broader economy – not as a vehicle for highly destabilizing financial speculation.

It could perhaps be added that eras of extreme inequality have a certain zesty drama about them that may seem lacking in more egalitarian times, with their textbook virtue, restraint and enforcement of the rule of law. "Money has lost its mystique and banking, therefore, has lost a bit of its magic," wrote Chernow almost wistfully at the end of his massive 1990 history of the J. P. Morgan empire, apparently saddened by the idea that "there will never be another barony like the House of Morgan." True, a larger-than-life financial titan running roughshod over the economy, vacationing with royalty and whipping presidents into line, does provide a lot of colour – as do today's rogue billionaires accumulating the riches of kings even as they fleece society's most vulnerable citizens. On the other hand, a little less drama in the lives of bankers might be a reasonable trade-off for a lot less devastation in the lives of millions of others.

End Notes

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17 Lundberg, 221.
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19 Paul Krugman, *The Conscience of a Liberal* (New York: W.W. Norton, 2007), 7-9, 46.
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28 Doug Peters, Interview by author. Peters later got a Ph.D. from the University of Pennsylvania's Wharton School of Finance, and served as Canada's minister of financial institutions in the 1990s.
29 This early postwar era, a time of restrained banking, reduced incomes for the rich and a rising middle class, was one of extraordinary economic growth and prosperity. It should be acknowledged that the rapid economic growth of the period proceeded with little attention to the severe environmental consequences that were unfolding. By stressing the prosperity of the period,

we don't mean to minimize the seriousness of this environmental degradation, but simply to note that it is a separate issue. Certainly there is no evidence that if the rich had remained dominant in the early postwar years that they would have done more to protect the environment. On the contrary, since the environment became an issue in the 1970s, environmentalists have received far more support from labour than from business for their campaign to reduce pollution and adopt green solutions. Our focus here is on inequality, and our point is that measures that reduced inequality in the early postwar period did not in any way hamper economic prosperity. On the contrary, the early postwar era, with its strong regulations and income redistribution measures, was a period in which the United States and Canada witnessed extraordinarily high levels of economic growth as well as great financial stability.

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