

INCREASING INEQUALITY, INADEQUATE DEMAND, STATUS INSECURITY, IDEOLOGY, AND THE FINANCIAL CRISIS OF 2008

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ABSTRACT: The most widely embraced explanations of the financial crisis of 2008 have centered upon inadequate regulation stemming from laissez-faire ideology, combined with low interest rates. Although these widely-acknowledged causal factors are true, beneath them lies a deeper determining force that has received less notice: the dramatic increase in inequality in the U.S. over the preceding 35 years. Heightened inequality generated three dynamics that made the economy vulnerable to systemic dysfunction. The first is that inequality constrained consumption, reducing profitable investment potential in the real economy, and thereby encouraging an every wealthier elite to flood financial markets with credit, helping keep interest rates low, encouraging the creation of new credit instruments, and fueling speculation. The second dynamic is that greater inequality meant that individuals were forced to struggle harder to find ways to consume more to maintain their relative social status. The consequence was that over the preceding three decades household saving rates plummeted, households took on ever-greater debt, and workers worked longer hours. The third dynamic is that, as the rich took larger shares of income and wealth, they gained more command over ideology and hence politics. Reducing the size of government, cutting taxes on the rich and reducing welfare for the poor, deregulating the economy, and failing to regulate newly evolving credit instruments flowed out of this ideology.

KEYWORDS: Underconsumption, deregulation, speculation, real estate boom, credit, conspicuous consumption, social respectability

JEL Classification Codes: E21; E44; G01

The dominant explanations of the current financial crisis have focused on deregulation and inadequate oversight resulting from laissez-faire ideology, low interest rates resulting from excessively loose monetary policy and a global glut of saving, “irrational exuberance” or “animal spirits,” and moral hazard.¹ Although these claims are true, they represent a surface reality, beneath which lies a deeper determining cause of the conditions in which such a crisis might occur. This deeper cause is the dramatic increase in inequality over the preceding 35 years. This rise in inequality generated three dynamics that underlie the crisis of 2008. The first resulted

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from limited investment potential in the real economy due to weak consumer demand as those who consume most or all their incomes received proportionately much less. Seeking profitable outlets for its dramatically increased income and wealth, the elite fueled first a stock market boom, and then after the high tech bubble burst, a real estate boom. It flooded financial markets with credit, helping keep interest rates low and encouraging the creation of new high-risk credit instruments.² Continuing economic growth was, in Kalecki's terms, profit-led as opposed to wage-led (Kalecki 1942).

The second dynamic is that greater inequality meant that households were forced to find ways to consume more to maintain their relative status, their social respectability. Pressure to do so was especially strong in housing, the most important symbol of social status for most Americans. As a consequence, over the past three decades the household saving rate plummeted, workers worked longer hours, and households took on ever-greater debt.

The third dynamic is that as the rich took an ever-greater share of income and wealth, they and their corporate interests gained relatively more command over ideology and greater influence over politics so as to change the rules of the game. In their competition for status among themselves, they understandably supported measures that brought them yet greater shares of the nation's income and wealth. They spontaneously gravitated toward political and economic doctrines that were supportive of their self-interests. And as their command over essentially everything grew, so too did their ability to craft self-serving ideology -- especially supply-side economics, a variant of laissez faire economics -- in a manner that made it be ever-more convincing to a majority of the electorate.³ Flowing out of this ideology were tax cuts favoring the wealthy, a weakened safety net, deregulation of the economy, and the failure to regulate newly evolving credit instruments.⁴

Given the importance Keynes assigned to inequality in accounting for inadequate aggregate demand, it is surprising that so little attention has been given to inequality, much less growing inequality as a potential causal factor in crises. Moreover, causal empiricism might have been expected to draw some attention to a possible relationship. Inequality increased dramatically during the decade preceding the crash of 1929. Further, according to Reinhart and Rogoff, whereas there was only one banking crisis between 1947 and 1976, there were 31 between 1976 and 2008 (2008: 6, Appendix). In the earlier period, inequality declined slightly, whereas in the later period it exploded.

Highly influential treatises on the Great Depression, e.g., Bernanke (2000), Friedman and Schwartz 1963, 1965, and Temin (1976, 1989) make no mention of a role for rising inequality in the generation or perpetuation of that crisis. Rising inequality has also received little attention within mainstream economics as a causal factor for the current crisis. A number of more heterodox economists, on the other hand, have pointed to rising inequality as a factor in setting the stage for the crisis of 2008. Palma, for instance, notes that “as good old-fashioned Keynesian economics has always emphasized...the current crisis has again shown that developments in financial markets are closely related to the distribution of income” (2009: 843). However, a systematic treatment of this relationship in the current crisis has not been found.⁵

The first dynamic resulting from greater inequality – the shift of investment from the real to the financial sector -- draws upon a rich collection of mostly heterodox crisis theory. Marxian theories of financial crisis have focused on long-run trends of aggregate profit, increasing centralization of firms, and increasing income inequality as playing the primary role in destabilizing financial markets (e.g., Kotz 2010). Minskian theories of inherent financial market instability have provided a rich framework for understanding asset price movements. Post-

Keynesians (e.g., Crotty 1992; Taylor 1985) have expanded upon this theory. Beyond structural explanations, theories based in behavioral finance focus on noise traders and “animal spirits” underlying irrational market behavior (Akerloff and Shiller 2009). Yet other explanations of the 2008 crisis have focused on particular characteristics specific to this crisis, including information asymmetry (Gorton 2008), racially targeted predatory lending (Dymski 2009a, 2009b), and the unique characteristics of the housing bubble boom and bust (Baker 2008). While the focus of this paper is on the lead-up to the 2008 crash, the first dynamic in its explanatory framework largely conforms to the above structural explanations in the theoretical tradition of Marx, Keynes, Kalecki, and Minsky.

The second dynamic – the struggle of households to maintain their social standing and respectability through consumption as inequality rises – has not been expressed beyond passing reflections made by Veblen. Yet, as will be seen below, Veblen’s rich theory of consumer behavior provide a deep social understanding of the manner in which rising inequality affects household behavior.

The third dynamic – the greater command over social ideology by the rich as inequality rises – has its roots in Marx’s theory of ideology and is developed by analyzing the manner in which right wing doctrines spread and influenced public policy as the wealthy took larger shares of income and wealth.

Financial crises are complex phenomena and the variety of explanations of why they occur is a testament to this complexity. The argument explored below is that rising inequality has also played an important role. However, the argument is not that all financial crises are in part due to rising inequality. The more modest claim is that some are and that this is one of those instances.

1976-2006: Three Decades of Exploding Inequality

Over the three decades following World War II, the U.S. became a more egalitarian society. Between 1946 and 1976, inflation-adjusted per capita income increased by about 90 percent. For the bottom 90 percent of households it increased by 83 percent, but only by 20 percent for the top one percent. However, over the following three decades -- between 1976 and 2006 -- whereas inflation-adjusted per capita income increased by 64 percent, for the bottom 90 percent of households it increased only by 10 percent. For the top one percent of households it increased a whopping 232 percent.⁶ A more detailed breakdown of this rising inequality can be seen in Table I below.

TABLE I⁷

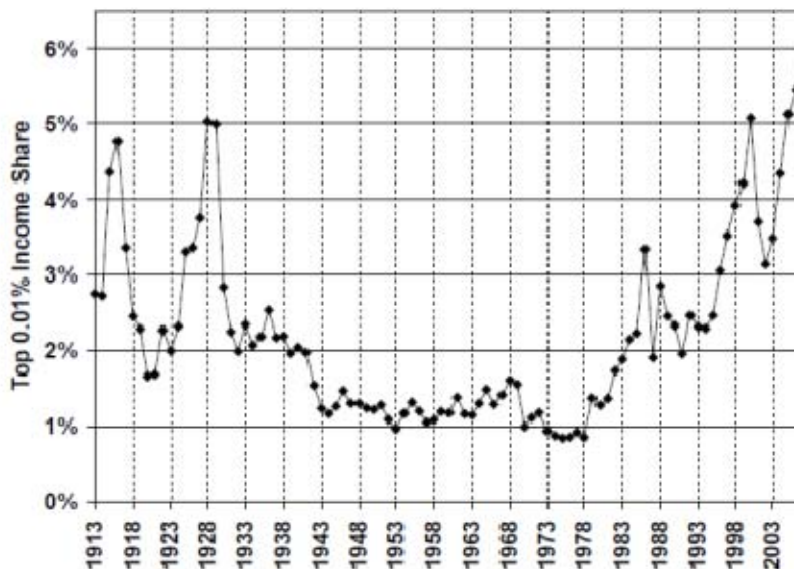
Increases in Real income by income group: 1976 to 2005 (CBO)

Income Percentile	Rise in Real Income (\$)	Percent Increase
Bottom 20	\$900	6.3
Second	\$4,600	15.8
Middle	\$8,700	21.0
Fourth	\$16,000	29.5
Top 20	\$76,500	79.9
Top 1	\$745,100	228.3

What is yet more striking is the dramatically larger share of income accruing to the ultra wealthy, the top one-hundredth of one percent (see Figure 1). Their income shares soared from about 0.9 in the mid 1970s to 6 percent in 2005, surpassing the previous extreme level attained in 1929. Equally astonishing, the seven-year expansion of the Clinton years provided the top one

percent with 45 percent of total growth in pretax income. They did even better during the four-year expansion of the Bush years, taking a full 73 percent (Palma 2009).

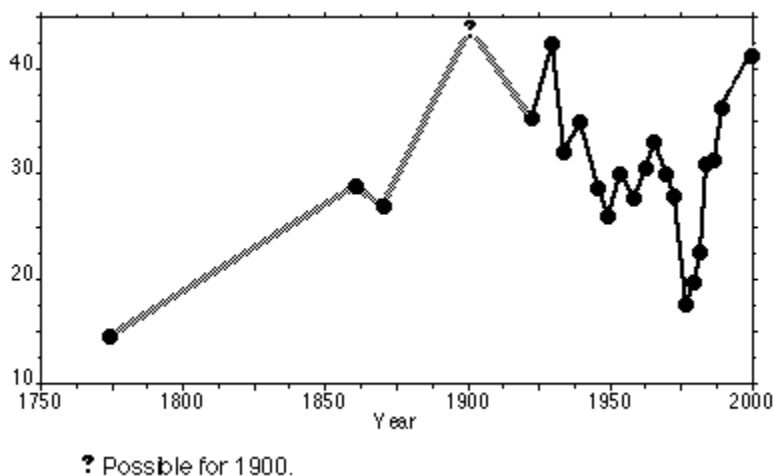
FIGURE 1



Source: [Saez 2009](http://elsa.berkeley.edu/~saez/saez-USStopincomes-2007.pdf) <http://elsa.berkeley.edu/~saez/saez-USStopincomes-2007.pdf>

Inequality in wealth ownership was yet far greater, and also greatly increased during this period (Wolff 2002). It has been estimated that on the eve of the American Revolution, the top one percent of households held about 15 percent of all wealth. By the end of the Civil War, they may have held 25 percent (DeLong 1997). Since the Civil War, as shown in Figure 2 below, there have been three major expansions in the share of wealth held by the super-rich, each taking the share held by the top one percent to near 40 percent: The first occurred between the end of the Civil War and lasted until about 1900. The second followed World War I and lasted until the late 1920s. The last expansion began in the mid 1970s and lasted up until the present crisis.

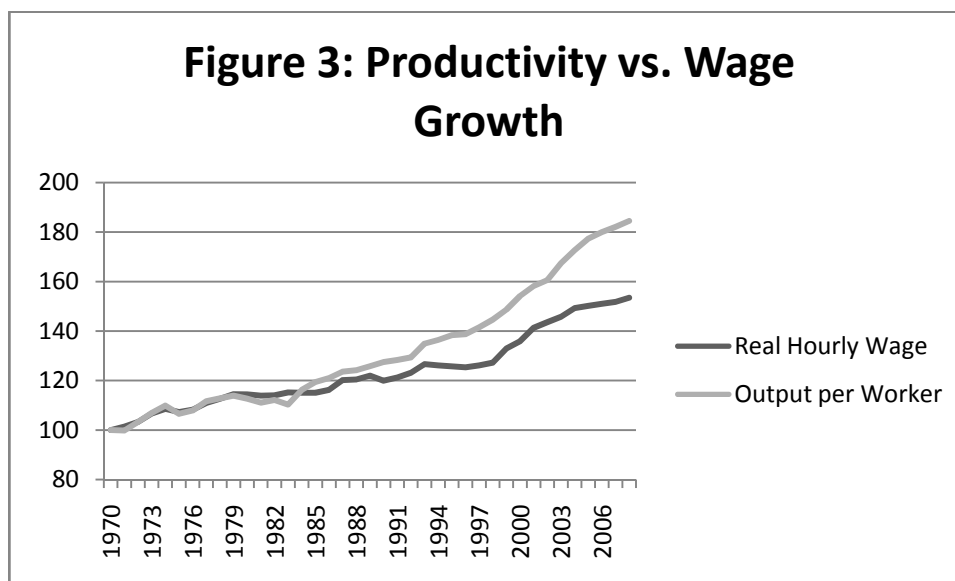
Figure 2: Crude Estimates of the Top 1% Share of National Wealth



Source: DeLong, Bradford 1997

Growing Inequality, Inadequate Demand, and Parking the Surplus

In 1970, labor's share comprised 60 percent of GDP while capital received 24 percent. In 2006, labor's share was 50 percent and capital's 29 percent⁸ (BEA NIPA). Whereas productivity increased by 90% between 1973 and 2008, average household pre-tax income increased by only about 15%. Consequently, the owners of capital experienced a huge windfall, according with what Long had pointed out long ago: "So large is labor's share of national income that any substantial disparity between productivity and real wages would exert great impact on the other shares – either largely expropriating them or presenting them with huge windfalls" (1960: 112). This can also be seen in the differences in the growth paths of wages and productivity (see Figure 3).



Source: BLS Labor Productivity and Costs (1970 indexed to 100).

This increased share of income and wealth accruing to an elite was far greater than could readily be spent, even on the most lavish consumption, leaving them and their money managers with the challenge of locating ways to place these increased assets to maximum effect. But given the fact that those who spend most or all of their income had a smaller share of total income to spend, profitable investment potential in the real economy was limited, a problem noted by Greenspan in his memoirs: “intended investment in the United States has been lagging in recent years, judging from the larger share of internal cash flow that has been returned to shareholders, presumably for lack of new investment opportunities” (2007: 387).

The financial crisis was able to sneak up on the economy because the dominant focus was on surface reality, on the fact, for instance, that between 1991 and 2006 growth averaged 3.22 percent and inflation never went above four percent. However, beneath the surface, dramatically rising inequality was shifting investment from production to finance and speculation.⁹ Economic growth was profit-led as opposed to wage-led, and thus in part an illusion. Growth became

increasingly dependent on consumption fueled by the wealth effect of rising asset prices and consumer debt.

Indeed, in the six or so years preceding the crisis, firms were investing less than their retained earnings – the longest period of such business behavior since the Second World War --, even as corporate profits as a share of national income nearly doubled. But these higher profits were being harvested principally in the financial sector. Whereas financial sector profits have generally constituted about 10-15 percent of corporate profit, they jumped to 40 percent in 2007 (Stiglitz 2008: 36).¹⁰ These profits came from such sources as the hefty transactions fees banks earned every time loans were sold, re-packaged and securitized.¹¹ Whereas finance and insurance accounted for less than four percent of GDP in the 1960s, it had risen to about eight percent by the eve of the crisis (Krugman 2009). As Palma has put it, “the value of financial asset not only decoupled from the real economy [but also inflicted] on the real economy ... a special version of the ‘Dutch disease’ [by] crowding out the non-financial tradable sector” (2009: 852). Financial stocks grew from 6 percent of the stock markets total value in the early 1980s to 23 percent by 2006 (Crotty 2009: 576). Whereas there were no financial corporations in the Dow Jones Industrial Average in 1982, by the onset of 2008 there were five (Palma 2009: 852).

The relative lack of new investment opportunities in the real economy prior to 2008 created a premium for financial entrepreneurs devising new financial investment instruments. Traditionally, banks that originated loans held them until maturity, providing good cause to scrutinize well the credit worthiness of the borrowers by checking for the three Cs: collateral, credit history, and character. What changed is that financial entities began to buy up mortgages and credit card debt and then package them in bonds backed by the monthly payments of the mortgage borrowers and credit card holders. The new model was “originate to distribute.”

Because profits would depend on fees rather than interest, there was a strong incentive to originate as many mortgages as possible. By moving their mortgages “off balance sheet” banks were freer from reserve and capital requirements. Between 1980 and 2000, this securitized debt expanded 50-fold, whereas bank loans expanded 3.7-fold. By the end of 2007, two-thirds of all private U.S. debt passed through Wall Street (Wilmers 2009: A19). Although banks no longer needed to be as cautious as to borrowers’ credit risk, “securitization” was widely believed to strengthen the financial system by spreading risk more broadly.¹² These bonds were then sliced up into various tranches based on their degree of risk.

These packaged securities were attractive to foreign investors looking for profitable and balanced placements for their dollar-denominated assets. Thus this process of securitization in an increasingly globalized financial world linked together by almost speed of light electronic communication enabled U.S. debt to spread around the globe, especially to Europe where it made banks as fragile as in the U.S.

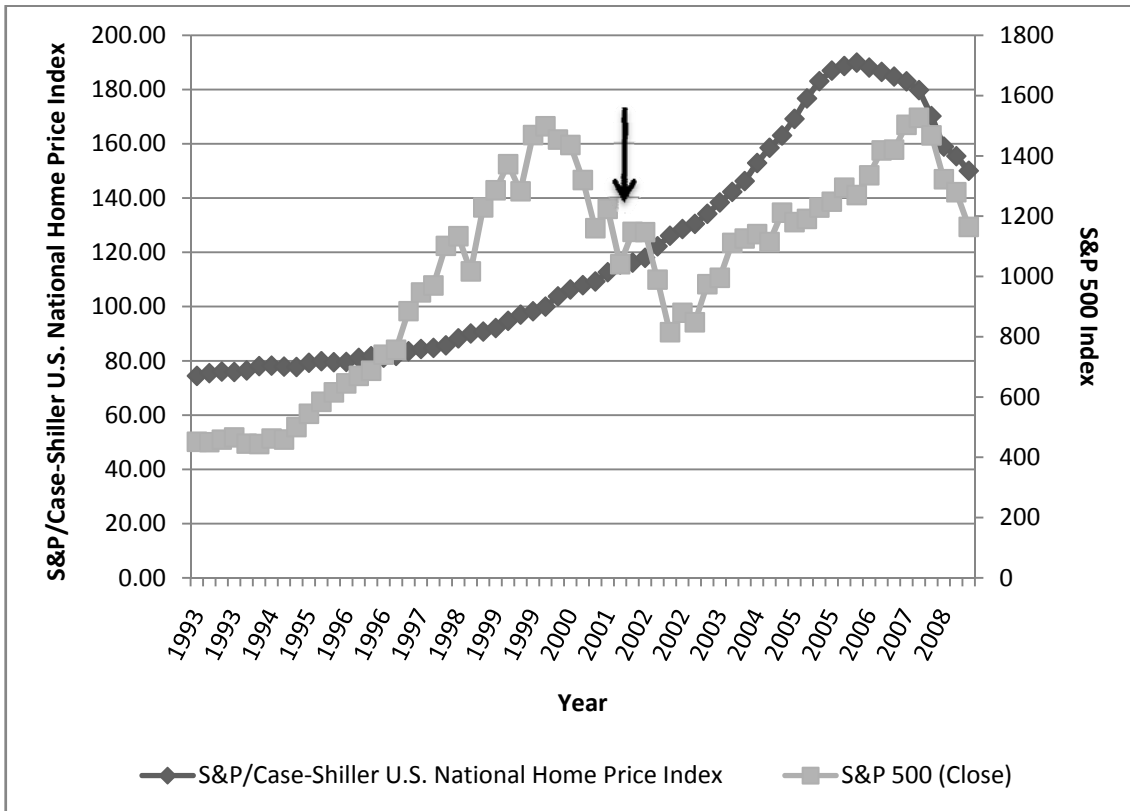
Given the dearth of investment potential in the real economy, new financial instruments drew more and more wealth into financial assets, causing them to increase from four times GDP in 1980 to ten times in 2007.¹³ Along with the booming high tech stocks of the late 1990s, financial assets seemed the most promising way to hold one’s wealth and make it grow. Indeed, such instruments as hedge funds seemed a low risk alternative or complement to the sizzling tech stock market.

With more wealth in the hands of those with less to lose from risky investments, the total amount of wealth held in stocks as a share of total assets more than doubled from 1983 to the crash in 2001 (Wolff, 2004: 11).¹⁴ By holding more wealth in the form of stocks, investors scrambled for ever-higher returns from these investments, generating the tech bubble of the late

1990s. While the bursting of this bubble did have some repercussions on the real sector, because the bubble was mostly limited to the stock market, its impact was primarily felt by those with money to invest, i.e. those in higher income brackets. In addition, an expanding housing market continued to grow through the bursting of the tech bubble, tempering the severity of the 2001 recession (See Figure 4). The growth of financial assets as a percentage of total assets stopped and reversed following the mild recession of 2001 (see Figure 5) (Bucks 2006, A10). More and more wealth was redirected into nonfinancial assets, especially real estate.¹⁵ Between 2001 and 2007, the market value of both “Primary residence” and “Other residential property” went up as a percentage of total assets (see Figure 6) (Bucks 2009, A28)¹⁶. The magnitude of this real estate boom can be seen by the fact that whereas the ratio of mortgage debt to Gross Domestic Product was about 27 percent during the 1970s, it stood at about 65 percent at the end of the 1990s, and then rose to about 96 percent in late 2007 (Household Debt 2010). Government policy stoked the fires of booming real estate prices. George W. Bush’s tax cuts, benefiting disproportionately the rich,¹⁷ produced, as Livingston put it, “a new tidal wave of surplus capital with no place to go except into real estate” (2009: 47).

Figure 4:

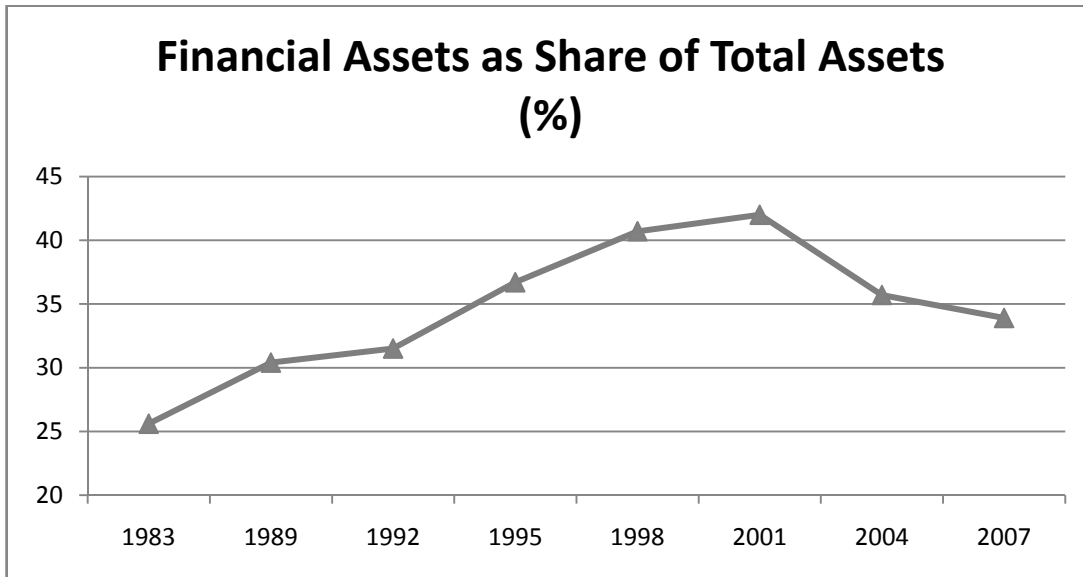
S&P/Case-Shiller U.S. National Home Price Index with S&P 500 Index



Source: *Standard and Poor's/ Case-Shiller Home Price Indices and S&P500 Index.*

The black arrow indicates the beginning of the 2001 recession. Note that housing prices continue to rise as if unfazed by the recession.

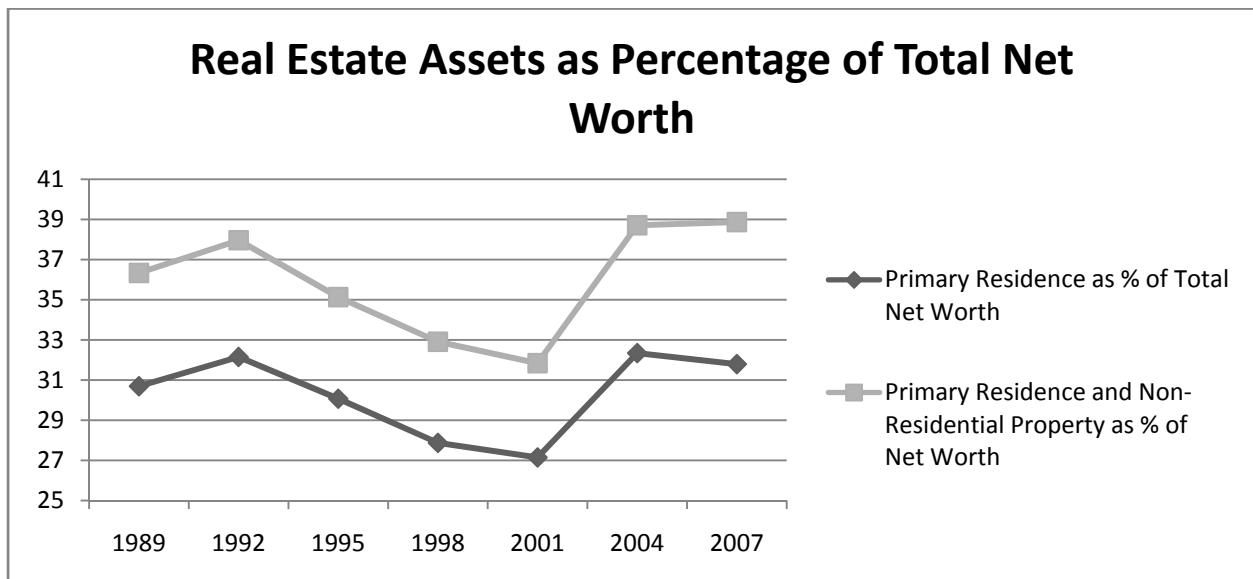
Figure 5



Source: *Survey of Consumer Finances 1992-2007*.

Financial assets as share of total wealth followed an upward trend until 2001.

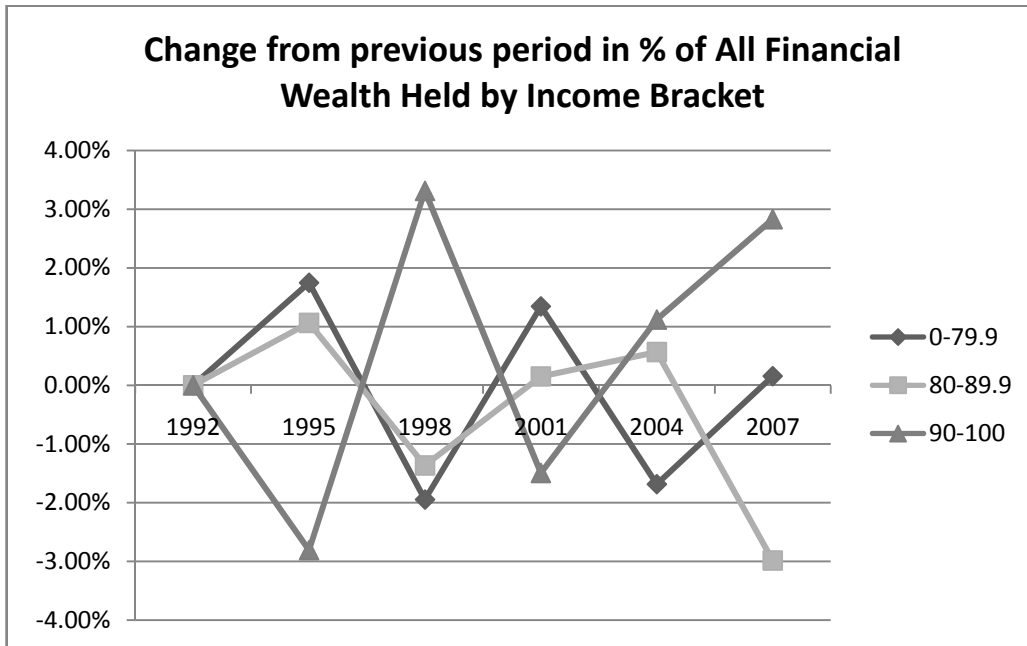
Figure 6



Source: *Survey of Consumer Finances 1992-2007*.

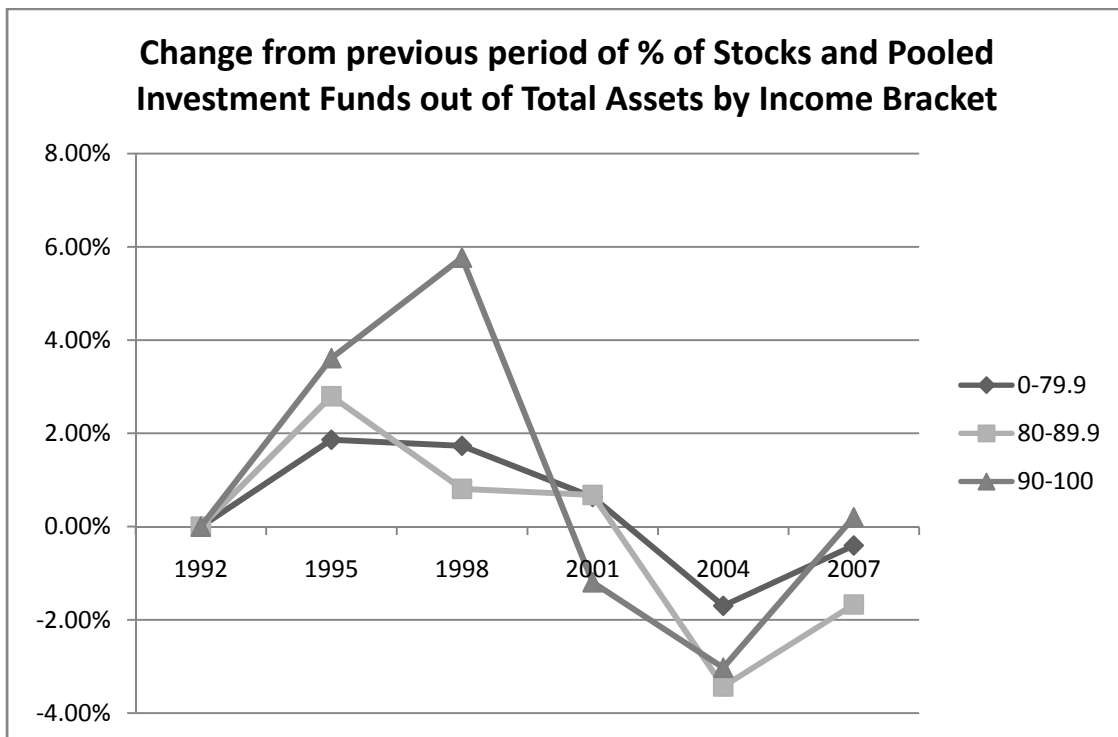
While the preceding statements and graphs show an important trend in wealth holdings following the 2001 crash, the more important story is what the wealthy did with their assets in the years leading up to the crash. From 1995 to 1998, the 90-100 percentile income bracket led the charge into financial markets, both by altering their own wealth portfolios and increasing their holdings of aggregate financial wealth. The top ten income percentile from 1995 to 1998 was clearly out ahead of other income brackets in moving into financial markets and obtaining a larger share of overall financial wealth. Emulating their richer cohorts in the following period (1998-2001), almost every other income bracket increased its share of total financial wealth (see Figure 7). This same pattern appears in comparing the wealth portfolios of different income brackets over time. The top income bracket made a more dramatic shift towards holding its wealth in stocks and investment funds than any other income bracket from 1992 to 1998, increasing the share of these assets in wealth portfolios by nearly 6 percent (See Figure 8). Both of these measurements show a clear behavioral difference between the rich and the rest of the population, with the rich jumping into financial markets first, followed by the emulative behavior of lower income brackets.

Figure 7



Source: Survey of Consumer Finances 2007 (Public Data).

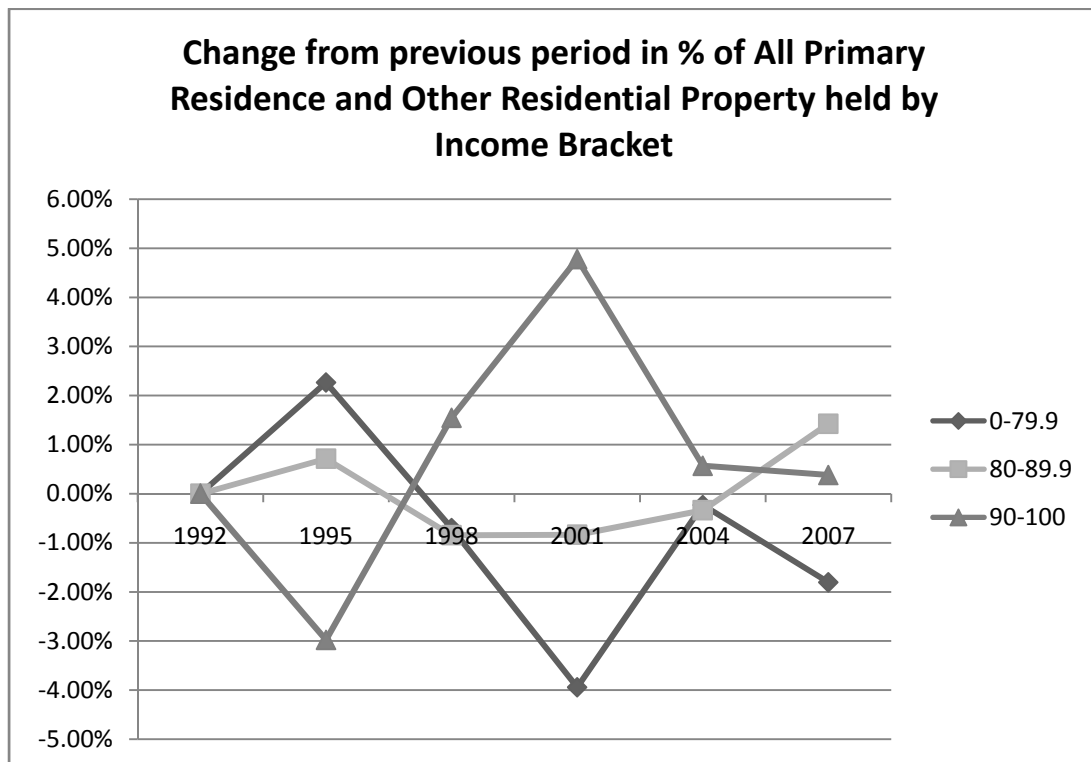
Figure 8



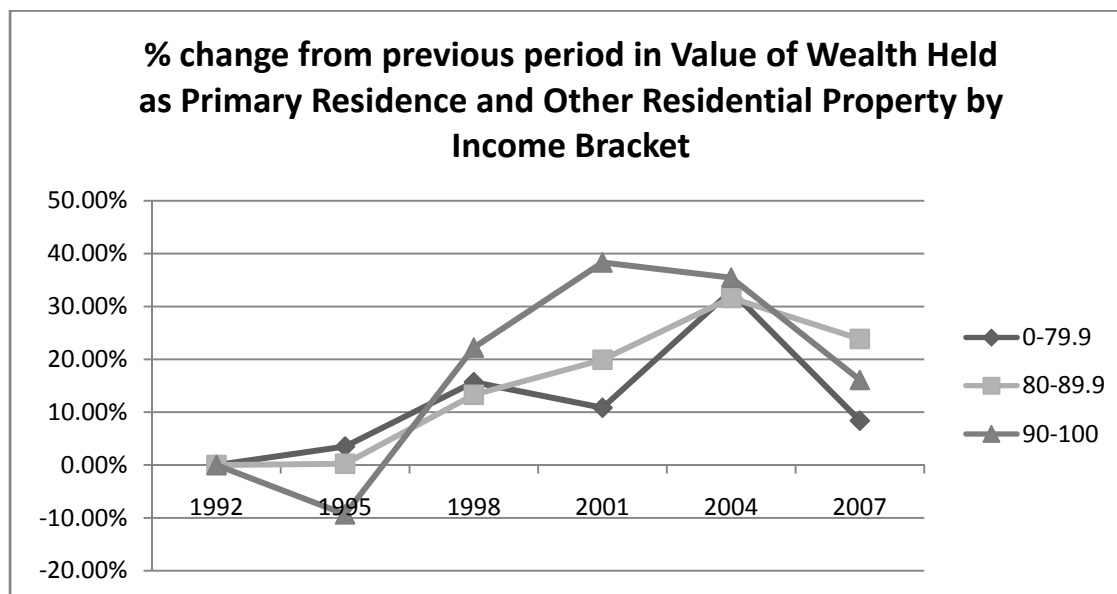
Source: Survey of Consumer Finances 2007 (Public Data).

From 1998 to 2001, almost all income brackets moved towards favoring financial forms of wealth. The only income bracket that showed a clear behavioral difference (again) was the top 10 percent. This wealthiest decile acquired a larger percentage chunk of all real estate from 1995-2001, when other income brackets were moving relatively away from real estate (see Figure 9). In addition, the percentage change in the top 10 percent's value of real estate wealth increased more than was the case in any other income bracket during this same period (see Figure 10). Once again, the other income brackets followed the actions of the rich in the following period, 2001-2004, as the latter began retreating from real estate (see Figure 9 and Figure 10).

Figure 9



Source: Survey of Consumer Finances 2007 (Public Data).

Figure 10

Source: Survey of Consumer Finances 2007 (Public Data).

The very wealthiest were clearly ahead of the curve in making investment decisions. This is to be expected given their generally superior educations and their capacity to hire the most talented financial advisors. These elite led the way in generating the next investment boom. This is most apparent in Figure 9. With ever-larger shares of total wealth, the elite had first flooded the stock market with liquidity. However, as if foreseeing pending difficulties in the stock market, they began to shift funds into the real estate market, turning it into an increasingly frothy speculative domain. Their actions set the stage for the housing bubble to take over where the tech boom left off, enabling it to take the place of the stock market in driving the economic expansion.¹⁸ As noted earlier, the top income decile was the only income bracket to move a significant portion of wealth from financial holdings into real estate from 1998 to 2001, the three years preceding the stock market crash.

With a plethora of credit fueled by rising inequality, overly expansionary monetary policy, inflow of foreign monies (Bernanke's "savings glut"),¹⁹ and greater use of financial instruments, financial institutions were not under pressure to limit lending to those who could realistically meet their debt obligations, since these loans would be bundled or securitized and sold. In Minskyean terms, these financial innovations "stretched liquidity," increasing leverage ratios and credit availability. Within the financial sector, debt rose from 22 percent of GDP in 1981 to 117 percent in 2008 (Crotty 2009: 575). Increased credit availability allowed those in lower income quintiles to obtain mortgages to pay for increasingly inflated housing prices. A Ponzi-like scenario developed in which banks, using the "originate to distribute" model could issue ever more debt "off balance sheet," thereby ignoring previous debt-holding requirements for consumers. Mortgage lenders saw great short-term gain potential in these sky-rocketing housing prices. But when low income borrowers could not make their mortgage payments, the collapse was assured.

A slowdown in the growth of housing prices or an increase in lending discipline might have tempered or even precluded the financial collapse of 2008. What promised to make the crisis severe was the breadth of participation. Whereas the percentage of households holding equity in their homes had remained at about 64 percent between 1975 and 1995, by 2007, almost 69 percent of households had invested in real estate through ownership of their primary residence. As the elite poured much of its increasing share of income and wealth into the real estate market, an extreme speculator's market evolved in the highly deregulated environment of the early 21st century (Bucks, 2009: A29). A measure of the frothiness of this bubble is that by 2006, the median house price reached \$234,000, having soared 40 percent since 2000. It was destined to collapse.

Real estate markets are more democratic than stock markets in that a larger share of the population participates in ownership, and for that reason, a collapse of a speculative bubble in real estate has consequences that are far greater and potentially far longer lasting. Thinner ownership of financial assets in the multiple other crises from the 1980s on (savings and loan crisis of the 1980s, stock market crises in 1987 and 2000, the 1994 Mexican crisis, the 1997 Asian Financial Crisis, the 1998 Russian default, and the LCTM bankruptcy) had less impact upon the real economy.

Rising Inequality, Conspicuous Consumption, and Status Insecurity

Rising inequality meant that those who spend most or all of their income had proportionately less to spend. It also unleashed a dynamic, that is well captured by Veblen's theory of consumer behavior. Greater inequality forced households to struggle harder to increase their consumption levels so as to maintain their relative social status and hence their self respect. Accordingly, consumption as a percent of GDP rose from 63 percent in 1980 to 70 percent in 2008.

In the U.S. since colonial times, there has been a relatively strong belief that vertical mobility is readily possible. Consequently, to a greater extent than in most other societies, Americans generally feel responsible for their own social status. If they are willing to put forth sufficient effort, they may improve their status. Through adequate dedication and effort, anyone can move up, even to the very highest levels of social status. It is the individual's responsibility. It depends upon the individual's willingness to study and work hard. One's social status is not given, but earned.

In modern economies, however, how hard one works is generally not directly observable. What more readily catches attention is how much one can consume, which can stand, more or

less, as a proxy for how hard one has worked.²⁰ Thus, because Americans believe they are individually responsible for their own social standing, they feel strongly compelled to demonstrate status and hence class identity through consumption. Indeed, their stronger belief in the potential for vertical mobility may well help explain why Americans have long consumed more (and saved less) than their counterparts in other wealthy societies (Wisman 2009).

An attempt to maintain or increase social standing through consumption is what Veblen meant by conspicuous consumption, and it manifests itself in two dimensions. Consumption that permits “invidious comparison” is meant to demonstrate one’s status to be above those below. “Pecuniary emulation,” on the other hand, refers to the practice of imitating the consumption standards of those of higher status with the intent of appearing to also possess that status. Veblen claimed that “With the exception of the instinct of self-preservation, the propensity for emulation is probably the strongest and most alert and persistent of the economic motives proper...[and] the propensity for emulation – for invidious comparison – is of ancient growth and is a pervading trait of human nature” (Veblen 1899: 110; 109).

Veblen’s theory of consumer behavior is founded upon the fact that social status is critically important to people and thus strongly affects their behavior. His conception of social status conforms to that of Karl Polanyi’s, whereby an individual is motivated “to safeguard his social standing, his social claims, his social assets” (1944: 46). Veblen gave an expressive account for the dynamics of this behavior in the following passage:

“In modern civilized communities the lines of demarcation between social classes have grown vague and transient, and wherever this happens the norm of reputability imposed by the upper class extends its coercive influence with but slight hindrance down through the social structure to the lowest strata. The result is that the members of each stratum

accept as their ideal of decency the scheme of life in vogue in the next higher stratum, and bend their energies to live up to that ideal. On pain of forfeiting their good name and their self-respect in case of failure, they must conform to the accepted code, at least in appearance....No class of society, not even the most abjectly poor, foregoes all customary conspicuous consumption” (Veblen 1899: 84, 85).²¹

Underpinning social status or respectability is the need for self-esteem or self-respect, what John Rawls suggested to be “perhaps the most important primary good” such that without it nothing else has much value (1971: 440). This conception of consumption being pursued for social respectability or social status and ultimately self-respect, differs from that set forth by sociologists such as Zygmunt Bauman (1988) who focus on consumption as a realm of unfolding freedom or autonomy and give but minor importance to its competitive aspect.

It might be noted that the human preoccupation with status or relative social position is understandable from an evolutionary perspective. Those with higher status, whatever its source, would possess disproportionate access to resources and members of the opposite sex, thus permitting more and better cared-for progeny. A proclivity for seeking status would thus be naturally selected. Or, as Robert Frank has put it, “falling behind one’s local rivals can be lethal” (2005: 183).

Within the general theory of competitive consumer behavior formulated by Veblen, greater inequality means that consumers must stretch further to maintain their relative social standing. This challenge to maintain relative status in the face of widening inequality may help explain why American consumption as a percent of GDP substantially increased between the mid 1970s and 2006 (Wisman 2009), whereas it did not do so in those other wealthy societies where inequality increased substantially less.²² The fact that the United Kingdom has

experienced a substantial rise in inequality and a simultaneous rise in the ratio of consumption to GDP lends support to this hypothesis.

The argument set forth here modifies Keynes' view that an increase in inequality could be expected to decrease consumption since wealthier households have lower marginal propensities to consume than do the less-well off (1936: 372-75). Keynes did not take into account the manner in which rising inequality pressures all households beneath the top to increase consumption to maintain their relative social status. Indeed, as will be seen below, households in all income deciles became more indebted. The fact that the very wealthy become so much wealthier means not only that they themselves significantly increase their own conspicuous consumption, but that because the gap between their consumption and that of those below them becomes so much greater, those below must spend ever-more to achieve their status goals.

Feeling compelled to consume more could be expected to prompt households to respond in one or more of three ways: People might consume more of their incomes, forcing them to save less; they might become more indebted to enable greater consumption, and they might increase the hours they work to enable them to increase their income and hence consumption levels. As the evidence presented below demonstrates, as a whole U.S. households did all three.

It is worth noting that while income inequality alone makes it more difficult for households to maintain their relative status, this struggle would have been less difficult had the potential for vertical mobility increased over this period. However, recent research suggests that the potential for upward mobility actually decreased, thereby compounding the difficulty that most Americans faced in maintaining status. Thus, not only did the differences between income

brackets rise, but it also become more difficult for American families to move into higher income brackets.²³

Where there is a strong belief that vertical mobility is possible, growing inequality puts additional pressure on households to struggle ever harder to maintain their relative status or demonstrate higher status through consumption. Increasing inequality means the status standard is ever higher. The struggle to keep up was especially intense in housing. As those at the pinnacle of wealth and income competed among themselves for status, they initiated what Wade has termed a “consumption arms race among elites” (2009: 20). Most notably, they bought and had constructed ever-larger mansions, thereby degrading the status quality of homes owned or occupied by everyone beneath them. Houses and cars are principal symbols of status and in the last decades leading up to the crisis there was an explosion in the consumption of so-called McMansions and extremely expensive cars.²⁴ Not surprisingly, a February 2008 Pew survey found that “the proportion of wealthy Americans who say they are very satisfied with their housing and cars, in particular, has declined considerably since 2001” (Pew Research Center 2008). As the wealthiest Americans received ever-larger income shares and increased their consumption more-or-less proportionately, they reduced the subjective value of consumption levels below them, fitting Veblen’s claim that:

“...in any community in which class distinctions are somewhat vague, all canons of reputability and decency, and all standards of consumption, are traced back by insensible gradations to the usages and habits of thoughts of the highest social and pecuniary class -- the wealthy leisure class” (Veblen 1899: 104).

As those below struggled to maintain their relative status by upgrading their own housing, the housing boom took off. The longer the boom continued, the greater became the

belief that housing was a solid investment, a belief strongly encouraged by the real estate industry. However, rising housing prices made all housing more expensive, with the result being that the housing affordability index declined from 147.3 in 1970 to 111.8 in 2005 (Miringoff and Opdyke (2008: 233).²⁵ In 2005, median household income was about three percent lower than in 1999. Over these six years, the average home price rose by 42 percent.

A “free-to-choose” interpretation does not adequately capture the dynamics of this intensified struggle. In consumption, people do, of course, choose. However, as Frank has noted, their choices are socially constrained:

“Increased spending at the top of the income distribution has not only imposed psychological costs on families in the middle, it has also raised the cost of achieving many basic goals. Few middle-income parents, for example, would be comfortable knowing that their children were attending below-average schools. Yet the amount that any given family must spend to avoid that outcome depends strongly on the amounts that others spend.... [Moreover], people cannot send their children to a public school of even average quality if they buy a home in a school district in which house prices are well below average” (2000: 258).

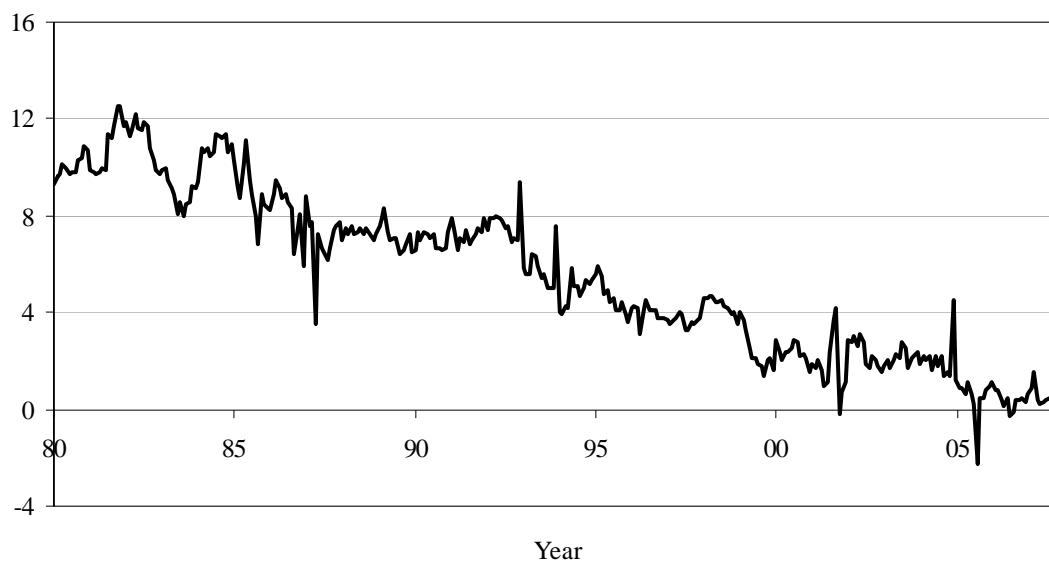
This dynamic was also noted by Christopher Lasch (1996). As economic elites took an ever-greater share of income and wealth, they tended to isolate themselves in social enclaves such as gated communities, exclusive clubs, and private schools. They tended to work in jobs, live in neighborhoods, and move in circles where they literally did not see those struggling to stay on their feet. Because of elites’ disproportionate political power, this withdrawal from the wider society and from direct contact with the concerns of less-well-off citizens eroded support for public services on which those further down the economic ladder depended -- services such

as schools, parks, transportation, even public safety.²⁶ The decay of public services encouraged those beneath the elites to do what was necessary – reduce saving, become more indebted, or increase work hours – to enable them to send their children to decent schools or to safe recreational facilities. And, of course, as those who could afford to consume the private provision of these services opted out of consuming the public ones, political support for, and the quality of, the latter continued to deteriorate. A vicious cycle was set in motion promising increasingly inferior public goods and ever-greater pressure to increase consumption of private substitutes.

As inequality increased over the three decades preceding the crisis, the struggle by households to maintain their relative status resulted in reduced saving, greater indebtedness, and longer work weeks. The personal saving rate fell from 10.4 percent in 1980-84, to 7.7 percent in 1985-89, to 6.5 percent in 1990-94, to 3.8 percent in 1995-99, to 2.1 percent in 2000-04; and and

became negative in 2005 and 2006²⁷ (See also Figure 3 below).²⁸

Figure 3: Personal Savings Rate
Source: Bureau of Economic Analysis



www.bea.gov/national/index.htm#personal

As inequality increased, households also took on more debt, especially between the early 1990s and 2007. Total household debt as a percent of GDP increased from about 45 in 1975 to about 70 in 2000 to 96 in late 2007 (BEA and Federal Reserve Flow of Funds Report). Wolf notes of this explosion in debt that “Nothing comparable has happened since the second world war, if ever. Indeed, on average households have run small financial surpluses over the past six decades” (2007: 13). This increased indebtedness held for households in all income quintiles. Not unexpectedly, the lower the quintile, the higher the level of indebtedness (See Table II below), due not only to stagnating wages, but also to the easier access to credit cards²⁹ and more aggressive mortgage lenders.

Although there are other hypotheses for why indebtedness of those in the lower part of the income distribution increased (e.g., Weller 2007), the rise in indebtedness for the rich and

poor alike fits the hypothesis set forth here: that in a society in which vertical mobility is believed to be highly fluid, increasing gaps in income all along the spectrum would stimulate everyone to struggle harder to meet their consumption status targets, as those at the very top compete among themselves for the very acme of status. Concerning the struggle for status, Wenning notes that “The \$6.2 trillion in debt that U.S. households took on between 2000 and 2007 fueled much of the consumer-related growth we've experienced in the past decade -- on SUVs, flat-panel TVs, and granite countertops and other luxury goods” (2008). Deregulation of credit instruments such as credit cards and home equity loans, and their greater availability greatly facilitated this emulative consumption (Scott 2007). Rapid expansion of subprime mortgages dramatically augmented indebtedness, and provided the coup de grace for the financial system. Supporting this hypothesis that rising inequality contributed to increasing indebtedness, Frank has found that in those parts of the U.S. where inequality had most risen over a ten-year period bankruptcy rates also rose most (2007).

It is noteworthy that increasing income and wealth inequality occurred even in the highest income decile, with the consequence that even those in this decile became, on average, increasingly indebted. The greatest gains in wealth and income were for the super-rich, the top 0.01 and 0.1 percents – the top one hundredth and top tenth of the top one percent (Saez 2008; Wolff 2002), dramatically increasing the consumption of extremely expensive goods and services (mansions, private jets, Hirschian positional goods, etc.). These super-rich households were in competition with each other for the pinnacle of status, demonstrating that “In the consumer race the finishing line always moves faster than the fastest of runners” (Bauman 2000: 72). This put pressure on the lesser rich who also wish to be seen as at, or near the top. This pressure was reinforced by the advertising and programming that continually keep the

consumption standards of the rich and famous on public display (See Schor 1998; Frank 1999).

TABLE II

Ratio of the Mean Value of Outstanding Debts to
Mean Family Income by Percentile

Income Percentile	Year						
	1989	1992	1995	1998	2001	2004	2007
All Families	0.88	1.08	1.09	1.20	1.05	1.47	1.50
< 20	0.89	0.33	1.85	1.84	1.68	2.31	2.56
20-39.9	0.86	0.35	1.12	1.23	1.12	1.62	1.54
40-59.9	0.85	0.42	1.03	1.19	1.18	1.61	1.72
60-79.9	0.96	0.71	1.14	1.32	1.16	1.56	1.82
80-89.9	0.84	0.85	1.08	1.14	1.12	1.47	1.77
90-100	0.60	0.62	0.76	0.79	0.68	0.99	0.87

Source: *Survey of Consumer Finances*

If, as a consequence of rising inequality, individuals had to consume ever more to attain their status targets, then it might also be expected that they would have increased their work hours to be better able to do so. Indeed, as inequality rose dramatically between 1970 and 2002, work hours per capita rose 20 percent in the U.S. By contrast, in the European Union where income inequality had not so much changed, work hours fell 12 percent (OECD 2004, Chapter 1). This relationship is supported by a study that found “that increased inequality induces people to work longer hours [and] ...the underlying cause is the Veblen effect of the consumption of the rich on the behaviour of those less well off” (Bowles and Park 2005: F410).

A Larger Slice and Command of Ideology

Why the political pendulum swung dramatically toward laissez-faire ideology between the mid-1970s and 2008 is complex and many causes have been suggested. Stagflation had delegitimized Keynesian economics,³⁰ setting the stage for a strong rejection of government intervention in the economy (Hirschman 1982). Also notable were the loss of gold backing of the dollar and its devaluation, loss of the Vietnam War, and with the widespread use of recreational drugs and sexual promiscuity, alleged rising moral degeneracy. But also important was the fact that rising inequality meant that the very rich had yet more resources with which to influence public opinion and policy, and research reveals that their expenditures on creating and disseminating ideology yield high returns (Glaeser 2006).

Different income and wealth groups have different interests and these interests are captured in ideologies that compete in the public sphere.³¹ On average, individuals spontaneously gravitate toward political and economic doctrines that are supportive of their self-interests. This is represented in the spectrum of political parties from right to left. Wealthy individuals generally support political parties on the right that best represent their interests just as poorer individuals generally support parties on the left that represent their interests. However, they come to this task with widely unequal assets. In addition to far greater material assets, the wealthy have the best educations, the most gifted friends and acquaintances, and all of this privilege makes them on average more astute and successful in attaining their interests than less-privileged citizens. Indeed, their more sophisticated educations mean that they are less likely to be fooled as to just what these self-interests are.³² In their competition for status among themselves the rich naturally gravitate toward ideologies supporting measures that bring them ever-greater shares of the nation's income and wealth.

In the United States, corporations are considered persons, having thereby many of the basic rights of citizens, such as the right of free speech, the right to contribute to political campaigns, and the right to lobby the government for their interests. And these corporations are overwhelmingly owned by the very rich. For instance, in 2007, on the eve of the crisis, the wealthiest one percent of Americans owned 49.3 percent of stocks and mutual funds, the richest 10 percent, 89.4 percent. The remaining 90 percent owned only 10.6 percent (Wolff 2010: Table 9: 52). Corporate entities have, of course, their own specific interests and these are not always the same as the interests of their wealthiest owners. Nevertheless, their interests and that of the very wealthy are more often harmonious than conflictual. After all, most CEOs can count themselves as among the very wealthy.

Over the 35 or so years prior to the crisis, an elite gained greater control over the media, educational institutions, and think tanks, making it more likely that their self-serving ideologies would come to be crafted so as to become ever-more convincing to a majority of the electorate.³³ It should be noted that because the rich are emulated, their ideologies have a decided advantage. As Veblen put this: “The fact that the usages, actions, and views of the well-to-do leisure class acquire the character of a prescriptive canon of conduct for the rest of society gives added weight and reach to the conservative influence of that class. It makes it incumbent upon all reputable people to follow their lead” (Veblen 1899: 200).

Some of the most notable media and think tanks shifted to the right. As Perelman points out, “the *New York Times*, *Washington Post*, the Ford Foundation, and the Brookings Institution, which had been aligned with a relatively centrist Democratic perspective, suddenly replaced their management with people much more receptive to the conservative view of the world” (2007: 63). Further, over the three decades leading up to the crisis of 2008, the media—newsprint,

television, and radio -- became increasingly concentrated into the hands of a few mega corporations. To a significant extent, this was due to deregulation. For instance, the number of newspapers controlled by chains went up significantly as a result of relaxed ownership regulations (McPherson 2008: 165). Blethen points out that “The majority of our media are controlled by just five companies... [such that] about one-third of the population now listens to radio stations owned by a single company....The 1996 deregulation of radio virtually ended local ownership in that medium” (2004: B7). A result of this increased media concentration is that criticisms of laissez-faire ideology and the corporate power structure became increasingly marginalized.

An important component of the increasing influence of conservative, free-market ideology was through the proliferation and empowerment of conservative think tanks. Conservative think tanks came to both outnumber and overpower their liberal counterparts. By the mid-1990’s, there were two conservative think tanks for every liberal one (Rich 2004: 206). While the five largest conservative think tanks all had total expenses greater than \$10 million, only the largest liberal think tank, the Center on Budget and Policy Priorities, could claim this feat. In fact, in 2006 the arch-conservative Heritage Foundation alone had larger expenses than the largest four liberal think tanks combined.

The economics profession in the U.S. also became more supportive of a free-market market approach to economic issues, thereby lending support to right-wing policies, even when such was not their intent. The liberal Keynesian support for government intervention in the economy that had matured in the 1960s and 1970s became marginalized.³⁴ As Crotty has put it, “Efficient financial market theory and new classical macro theory replaced the theoretical visions of Keynes and Minsky, and the existing system of tight financial regulation was deconstructed

through radical deregulation pushed by financial institutions and justified by efficient financial market theory” (2009: 564). More arguments were set forth in favor of privatization of social security and government services generally.³⁵ The pre-1980s concern with poverty and inequality all but disappeared. The 1995 recipient of the Nobel Memorial Prize in Economic Sciences even went so far as to declare that “Of the tendencies that are harmful to sound economics, the most seductive, and in my opinion the most poisonous, is to focus on questions of distribution” (Lucas: 2004).

Palma has characterized this “neo-conservatism,” following Foucault, as “a new technology of power to help transform capitalism into a rentiers’ delight...[and that] A key component in the effectiveness of this new technology of power was its ability to transform the state into a major facilitator of the ever-increasing rent-seeking practices of oligopolistic capital” (2009: 883).³⁶

Because of the wealthy’s increased command over society’s dominant ideology, the losers – the overwhelming majority of Americans – did not use the political process to stop the extraordinary reallocation of income and wealth toward the very rich. Through the democratic process, they could force the creation of compensatory measures to relieve workers harmed by technological change or international trade. Taxes could have been restructured in their favor, and public services that benefit them such as retraining, day care, better schools, health care and public recreational facilities could have been vastly expanded and improved. However, the wealthy’s increased control over ideology resulted in a majority of citizens buying into the rich’s ideology that such measures would not be either to their own or the country’s benefit. As Robert Reich, Secretary of Labor during the Clinton administration put it: “As inequality has widened, the means America once used to temper it – progressive income taxes, good public schools, trade

unions that bargain for higher wages – have eroded” (2007: 4). “As money has risen to the top, so has political power. Politicians are more dependent than ever on big money for their campaigns” (2010).

As the financial sector grew and became increasingly important as a means for transferring wealth to the very rich, it gained ideological influence. As Simon Johnson, former chief economist at the International Monetary Fund put it, “...the American financial industry gained political power by amassing a kind of cultural capital – a belief system...[such that] the attitude took hold that what was good for Wall Street was good for the country...[and] crucial to America’s position in the world.... Faith in free financial markets grew into conventional wisdom – trumpeted on the editorial pages of *The Wall Street Journal* and on the floor of Congress” (2009). This influence extended to the Federal Reserve System, which became complicitous in the growth of banks that in the crisis would be deemed too large to fail. Between 1999 and 2009, it approved 5,670 applications from banks to merge with other banks. It only denied one of these requests (Appelbaum and Cho 2009: A6). The reason, according to Buiter, is that financial authorities internalize “as if by osmosis, the objectives, interests and perceptions of reality of the private vested interests that they are meant to regulate and survey in the public interest” (2008: 106; cited in Bresser-Pereira 2010: 5). Those financial interests also spent lavishly to get what they wanted, making \$1.7 billion in campaign contributions between 1998 and 2008, and spending \$3.4 billion to plead their case through lobbying (*Wall Street Watch* 2009: 17; cited in Crotty 2009: 577). There has also been a revolving door between the regulated and the regulators, between CEOs in powerful financial institutions and the Fed, Treasury, and the SEC.

The consequences of the increasing dominance of ideology that privileged the very wealthy were not only that income, wealth, and privilege became more unequally distributed, but that with much of the electorate distracted from economic issues or convinced by the elite's ever-more sophisticated ideology,³⁷ markets were deregulated and necessary new regulations were blocked, thereby changing the rules of the game and setting the stage for financial meltdown.

Since antiquity, interest rates were capped by usury laws, and for much of U.S. history, state and local laws continued to curb financial power by setting caps on interest rates and fees. However, a Supreme Court decision in 1978 (*Marquette National Bank v. First of Omaha Services Corp*) claimed that a state could not control interest rates charged by an out-of-state bank. In addition to sweeping away usury laws, the credit card industry was also effectively deregulated. U.S. court decisions were beginning to reflect the general deregulatory trend that was sweeping through the economy as stagflation was blamed on governmental interference in the workings of the economy. The result of this court decision was that contracts with consumers became unintelligible and banks were free to impose high interest rates, fees, and penalties.³⁸

Deregulation sped up after the 1980 election of Ronald Reagan. The Garn-St. Germain Act of 1982 loosened regulation of the saving and loan industry, setting the stage for a crisis in that sector such that in the late 1980s, the number of S&Ls decreased by about 50 percent and about 1400 institutions received federal monies or closed. The Secondary Mortgage Market Enhancement Act of 1984 legalized mortgage-backed securities in all states. The Gramm-Leach-Bliley Act of November 1999 abolished the investment limits set on banks by the Glass-Steagall Act (a "firewall" between investment and commercial banking that Roosevelt had characterized at its creation in 1933 as an act to limit bankers' ability to speculate with "other people's money"). Clearly, the wealthy had gotten better at waging campaigns against state controls over

activities from which they drew income. As Johnson put it, “The great wealth that the financial sector created and concentrated gave bankers enormous political weight – a weight not seen in the U.S. since the era of J.P. Morgan (the man)” (2009). So powerful was this weight that the limit on investment bank leverage of 12 times capital was raised in 2004 by the Securities and Exchange Commission to 40 times capital with compliance becoming voluntary (*Wall Street Watch* 2009: 17; cited in Crotty 2009: 574).

Deregulation of the financial sector (banks, insurance companies, brokerages, real estate, etc.) led to increasing concentration in the banking industry and to booming profits,³⁹ hardly a surprise given that banks began charging interest rates on credit cards as high as 30 percent, and an increasing assortment of expensive fees. Further, it led to an explosion in so-called fringe banking such as check cashing, pawn, payday-loan and cash-advance shops that offer services to low income households at extremely high interest rates. Deregulation contributed to a shift of money out of investment in the creation of real capital and into the financial sector. The underinvestment in the goods-producing sector led to a weak export sector and increasing imports, generating an increasingly large trade deficit. These dollars abroad flowed back into the U.S. financial system, helping keep interest rates low and fueling profitability. And because these dollars flowed back, the ever-growing trade deficit did not cause the value of the dollar to dramatically fall, thereby allowing the trade deficit to continue growing as exports remained expensive and imports cheap.

It Happened Before: The Financial Crisis of 1929

In October of 1929, the stock market crashed and the Great Depression followed. There were many differences in the economies that led up to the crises of 1929 and 2008. For instance, in 1929, the government constituted only about three percent of GDP versus about 22 percent in

2008. Whereas extreme speculation on the eve of the current crisis was most visible in the real estate market, it was in the stock market in the late 1920s. Yet beneath such differences were striking similarities.

Booms in the market for homes – the most important status symbol and store of wealth for most households -- were common to both periods. In both periods, taxes on the rich were substantially cut.⁴⁰ Income distribution became radically more unequal in both periods,⁴¹ meaning that households had to struggle ever-harder to maintain their relative social status, their social respectability. In both periods an elite had ever-rising amounts of money to invest, but because the non-elite had less to spend,⁴² investment potential was greater in the financial as opposed to the production sector. Thus in both periods investment funds were being switched from production to speculation, which stimulated innovations in credit instruments. In both periods, a wealthy elite's possession of an ever-rising share of society's income enabled them increasing command over political ideology. In both periods, political attention was diverted away from economic to cultural issues. As cultural wars divided the electorate in the post-Reagan era, so too the 1920s saw political combat over such issues as evolution, prohibition, immigration, and the increasingly militant Klu Klux Klan.⁴³

By the late 1920s, about 80 percent of U.S. households had radios, bringing advertising into living rooms. Radio advertising helped erode the historical thriftiness of American families. Households were encouraged to buy on the more value-neutral term, "credit," as opposed to taking out loans. And to enable them to better do so, installment-plan financing developed. Between 1913 and 1929 the ratio of private credit to Gross Domestic Product nearly doubled.

Final Reflections

The argument explored in this article is not that all financial crises result from rising inequality, only that some do and that the current crisis, as well as the one that began in 1929, are examples. During the 1920s and over the three decades prior to 2008, concern about rising inequality was widely dismissed as either irrelevant or missing the economic dynamism that inequality generates.⁴⁴ Its irrelevance was supposedly that if everyone is becoming materially better off, the size of shares is unimportant. What this discourse missed was the behavioral and political changes generated by rising inequality, changes that would make the economy increasingly vulnerable to a severe financial collapse. Economic crises are as much about sociology and politics as economics.

The crisis of 1929 marked a turning point, reversing rising inequality, and ushering in roughly four decades of democratically-driven policies that significantly lessened inequality.⁴⁵ Might the crisis of 2008 ultimately promise to have similar distributional consequences? Perhaps. As Milton Friedman put it, “Only a crisis—actual or perceived—produces real change (1982: ix).

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NOTES

¹ "The financial crisis was caused by significant gaps in oversight" (Geithner, cited in Cho and Goldfarb 2009: A14). Although housing prices rose 175 percent between 1997 and 2007 in the U.S., Bernanke declared before Congress in Oct 2005 that housing prices "largely reflect economic fundamentals" (Bernanke 2005), despite warnings from many economists of a dangerous speculative bubble about to explode (e.g., Shiller 2005; Krugman 2005). Leijonhufvud claims that "the Fed was lured into keeping interest rates far too low for far too long. The result was inflation of asset prices combined with a general deterioration of credit quality" (2009: 742). Because it helped maintain low interest rates, John Taylor has laid blame for the crisis on the Federal Reserve (2009). Akerloff and Shiller focus on the generation of speculative booms by mass psychology (2009). The moral hazard resulting from the Federal Reserve bailing out financial actors and thereby limiting their risks has been termed "the Greenspan put."

² Bernanke (2004) had credited financial innovation for allocating capital and risk more efficiently and wise monetary policy as underlying the "Great Moderation" of the business cycle since the disinflation of the 1980s.

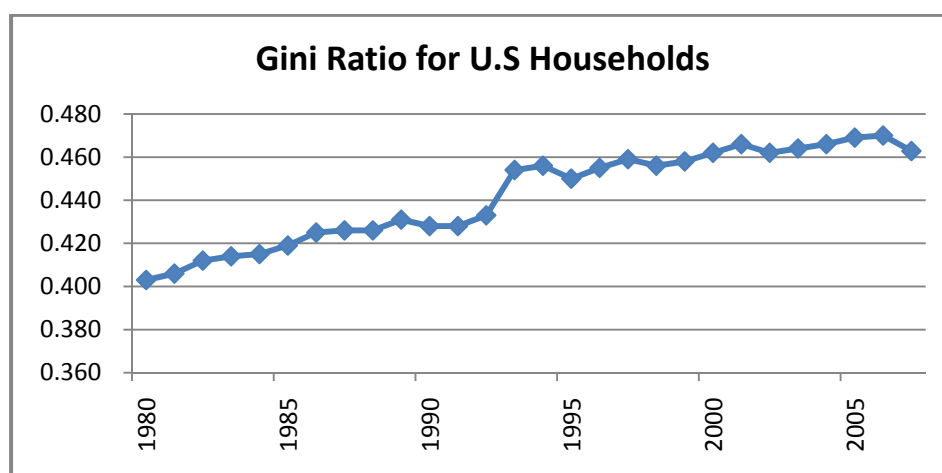
³ This has been the view of Stiglitz: "The downturn is likely to be so severe partly because we have succumbed to the opinion that markets work best by themselves, unfettered by government regulators. But the people making this argument are the ones who have been served well by it" (2008: 36).

⁴ The shift in political power resulting from growing inequality helped enable the financial deregulation that Bordo et al. (2001) have found frequently preceding financial crises over the past decades.

⁵ What makes this even more surprising is that even well before Keynes, the role of rising inequality in provoking systemic dysfunction was recognized by major thinkers such as Marx and Veblen. Indeed, as early as the end of the 17th C. Pierre de Boiguilbert noted that the distribution of income in favor of the rich who would hoard much of it and away from the poor who would spend it contributed to the disastrous decline of the French economy during the reign of Louis XIV (Boisguilbert 1695).

⁶ Income distribution became even more unequal than these data reveal, if the declining availability of public goods consumed by the less privileged is taken into account.

⁷ There are many other ways of depicting this rising income inequality. For instance, the poorest 20 percent of Americans saw their share of total income decline from 5.5 percent in 1973 to 4.0 percent in 2006. Over the same period, the second poorest 20 percent saw their share drop from 11.9 to 9.5 percent, the middle 20 percent from 17.5 to 15.1. Meanwhile, the share of the richest 20 percent rose from 41.1 to 48.5 percent. And the richest five percent saw their share climb from 15.5 to 21.5 percent (Table 1.7, Mishel et. al. 2009). The rise in the Gini Coefficient depicted in the chart below provides a graphic glimpse of this growing inequality.



Source: Bureau of the Census, Historical Income Table H-4
<http://www.census.gov/hhes/www/income/histinc/h04.html>

⁸ These figures are computed using “wage and salary accruals” for the labor share and the sum of “proprietors’ income”, “rental income of persons”, “corporate profits” and “net interest and miscellaneous payments”. (All with inventory valuation adjustment and capital consumption adjustment where appropriate).

⁹ This shift in investment from production to finance was occurring even within major traditional manufacturing firms such as General Motors, Ford, and General Electric, that developed increasingly powerful financial departments. In the case of GM and Ford, it was to finance the sale of their vehicles. By 2000, General Electric received more income from financial transactions than from manufacturing.

¹⁰ This was equally true of pay. Average compensation in the financial sector was close to parity with that of all domestic private industries between 1948 and 1982. However, it soared to 181 percent of the average level of other industries by 2007 (Johnson 2009).

¹¹ Home sales and mortgage securitization fees have been estimated to have been about two trillion dollars between 2003 and 2008 (*Financial Times* 2009; cited in Crotty 2009: 565).

¹² Even though securitization was clearly implicated in the failure of the energy giant Enron in 2001, the Federal Reserve continued to argue that securitization made banks safer. As New York Fed Chairman Timothy Geithner put it in 2006, “In the financial system we have today, with less risk concentrated in banks, the probability of systemic financial crises may be lower than in traditional bank-centered financial systems” (2008; cited in Crotty 2009: 572). The IMF also claimed that credit risk dispersion “helped to make the banking and overall financial system more resilient” (Tett 2009; cited in Crotty 2009: 572). Providing background theoretical support was the efficient market hypothesis of neoclassical economics contending that prices would correctly capture risks.

¹³ In Marxist terms, as Kotz has put it, “An asset bubble can prolong an expansion by holding off the realization crisis that tends to result from rising inequality” (2010: 9).

¹⁴ In 1983, 16 percent of Americans owned stock directly or indirectly and they constituted about 12 percent of household assets. By the eve of the crash in 2001, over 50 percent owned stocks which represented 44 percent of household assets. Nevertheless, this ownership was extremely skewed. In 2007, the wealthiest one percent of Americans owned 49.3 percent of stocks and mutual funds, the richest 10 percent, 89.4 percent. The remaining 90 percent owned only 10.6 percent (Wolff 2010: Table 9: 52).

¹⁵ Hudson points out that “Financially, mortgages account for 70 percent of the U.S. economy’s interest payments, reflecting the fact that real estate is the financial system’s major customer.” Further, “As the economy’s largest asset category, real estate generates most of the economy’s capital gains” (2010: 1).

¹⁶ The Survey of Consumer Finances (SCF) is a tri-annual survey conducted by the Federal Reserve Board that collects wealth and income data on a subset of the population. The focus of the SCF is providing detailed data especially for the upper income brackets. All observations are at the household level.

¹⁷ The effective income tax rate on the top 400 income-tax payers was reduced from 30 to 18 percent (Francis 2008; noted in Palma 2009).

¹⁸ A sustained housing boom is an especially powerful motor for powering the economy because ownership participation is so widespread, propelling consumption wealth effects, and because the huge construction industry is stimulated by ever-rising housing prices.

¹⁹ Palma has suggested that the “huge income polarization – between 1980 and 2006 just the taxable income of the top 1% increased by nearly US\$2 trillion, and that of the top 10% by US\$3.5 trillion – obviously became one of the major contributors (and one probably more important than the Asian ‘savings glut’) to the increased liquidity in the US financial markets...” (2009: 842).

²⁰ Veblen put this as follows:

“One’s neighbours, mechanically speaking, often are socially not one’s neighbours, or even acquaintances; and still their transient good opinion has a high degree of utility. The only practicable means of impressing one’s pecuniary ability on these unsympathetic observers of one’s everyday life is an unremitting demonstration of ability to pay” (1999: 86-87).

²¹ Veblen essentially embraced what later social thinkers such as Bourdieu (1984) and Sayer (2005) refer to as a Pascalian view of human action, whereby rational deliberation is of lesser importance than socialization and habitualization. Conspicuous consumption for Veblen is not so much consciously pursued as the engrained practice of struggling to maintain respectability:

“For the great body of the people in any modern community, the proximate ground of expenditure in excess of what is required for physical comfort is not a conscious effort to excel in the expensiveness of their visible consumption, so much as it is a desire to live up to the conventional stand of decency in the amount

and grade of goods consumed” (1899: 102).

²² Many of the increased costs in the U.S. resulting from changing social life conditions such as dual household income earners, divorced parents, child care, etc. have comparably affected household budgets within other rich countries.

²³ An OECD study (d’Addio 2007) finds upward mobility between generations to be lower in the U.S. than in Canada, Sweden, Germany, Spain, Denmark, Austria, Norway, Finland, and France. Further evidence that the U.S. is no longer the exceptional land of great equality of opportunity is provided by a number of other studies (Bradbury and Katz 2002: 4; Hertz 2007; Mishel, Bernstein, and Allegretto 2007; Mazumder 2005; Solon 1992). Nevertheless, the general view in the U.S. continues to be that it is the exceptional land of opportunity.

²⁴ Wilkinson and Pickett note that “research confirms that the tendency to look for goods which confer status and prestige is indeed stronger for things which are more visible to others” (2009: 225).

²⁵ This index measures one-quarter of median family income as percent of the funds necessary to qualify for an 80 percent mortgage on a median-priced home.

²⁶ Reich has made the same point: the elites “see no reason why they should pay to support families outside the gates when members are getting everything they need inside...@ (Reich 2001: 199).

²⁷ Undoubtedly, other forces also played a role in the declining rate of household saving. However, after examining the major “theories/explanations” for the fall in saving rates (wealth effects, “new economy” effect, financial innovation, social security programs and macroeconomic stability, demographics, Ricardian equivalence, and trends in the way companies compensate shareholders), Guidolin and La Jeunesse conclude that “none of them provides a compelling explanation” (2007: 491; See also Attanasio and Paiella 2001: 110). Similarly, Munnell, Golub-Sass and Varani note that “Economists have spent a lot of energy attempting to explain the precipitous drop, but with little success” (2005: 2).

²⁸ For an extended discussion of Veblen’s theory of consumer behavior applied to U.S. saving behavior, see Brown 2008; Wisman 2009.

²⁹ The securitization of credit card debt began in the early 1990s, enabling Wall Street brokers to sell bonds backed by credit card debt. The new profit possibilities greatly stimulated the aggressive marketing of credit cards.

³⁰ As Chicago School economist John Cochrane has put it, “When inflation came in the nineteen-seventies, that was a major failure of Keynesian economics” (cited in Cassidy 2010: 31).

³¹ Following John Thompson, ideology as used here is understood as “the ways in which meaning is mobilized in the service of dominant individuals and groups” (1991: 73).

³² The rich do not, of course, opportunistically pursue their own interests any more than do other folks. It’s just that their privileged status and greater resources mean they can do it better. And, like folks generally, they do not see themselves as consciously doing so. All people want to be highly principled, to see themselves as supporting the causes of the good and just society. They come to believe quite sincerely that the economic doctrines they support are best for the country, for its freedoms, its fundamental values, and in fact, best for the future well-being of all humanity. This is why it is a mistake to blame the crisis on greed. Individuals respond to the incentive structures embedded in social institutions. The task, therefore, is to pass judgment not on individuals, but on social institutions that provide socially destructive incentives. The challenge is to craft institutions to elicit the behavior that is deemed necessary for the best social outcomes.

³³ According to Palma, neo-liberal ideology “provided the technologies of power with the required degree of sophistication for accomplishing the most remarkable ‘dispossession feat’ ever within a democracy” (2009: 863).

³⁴ Palma claims that, “there is no doubt that a powerful fight took place during the 1970s between those interests backing the welfare state (working class, some industrial capitalists, some political parties and intellectuals) and those wanting to dismantle it (financial rentiers, other industrial capitals, some political parties and intellectuals, including most economists)” (2009: 840). Perez contends that “most neoclassical economists ...tend to lay blame on government...[for the] derailment of the market mechanism” (2009: 779).

³⁵ Bresser-Pereira argues that “Neoclassical economics played the role of meta-ideology as it legitimized, mathematically and ‘scientifically,’ neoliberal ideology and deregulation.... Neoliberalism...should not be understood merely as radical economic liberalism but also as an ideology that is hostile to the poor, to workers and to the welfare state.” Further, “neoclassical macroeconomists and neoclassical financial economists built models that have no correspondence to reality, but are useful to justify neoliberalism ‘scientifically’” (2010: 2; 3; 23).

³⁶ Palma went on to note that “It is not the first time in recent history that rentiers have tried to get rid of all fetters on their greed and transfer all associated risks; however, they have never succeeded on such a scale” (2009: 863).

³⁷ Further, noted political scientist Sheldon Wolin has claimed that the majority of Americans were being depoliticized.

“The intense pace of work and the extended working day, combined with job insecurity, is a formula for political demobilization, for privatizing the citizenry...[This] depoliticization is promoted through society’s being enveloped in an atmosphere of collective fear and of individual powerlessness: fear of terrorists, loss of jobs, the uncertainties of pension plans, soaring health costs, and rising educational expenses” (2008: 239).

³⁸ Evidence of this unintelligibility is presented in a 2007 Federal Trade Commission study that found that nine out of ten mortgage customers could not figure out the up-front costs on the loan after examining what were relatively straightforward fixed-rate loan contracts. One-half were unable to clearly identify the loan amount. Further, almost 60 percent of those who took out subprime mortgages between 2002 and 2007 could have qualified for prime mortgages if they had been offered. Brokers were rewarded for steering buyers to these higher interest mortgages (Brooks and Simon 2007). The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 also made it far more difficult for homeowners to get out of mortgage debt.

³⁹ Tregenna finds “a precipitous and continuous drop in the number of banks from the mid-1980s on. Whereas in the previous half-century the number of commercial banks hovered within a fairly narrow band, the number fell dramatically from about 1985 onwards.” As a consequence, “by the early 1990s profitability reached a new historical high, only beginning to decline (and dramatically so) in 2006 and 2007 as the current crisis began.” Tregenna’s econometric study found “A positive and highly significant relationship ...between concentration and profitability” (2009: 611; 613; 628).

⁴⁰ President Calvin Coolidge and his Treasury Secretary Andrew Mellon energetically campaigned to drastically cut taxes on the highest incomes. By 1928 the richest 10 percent received 46 percent of total income. In their search for profitable investment outlets, they fueled ever-more extreme speculation. Similarly, while top marginal tax rates were reduced from a range of 70 to 90 percent during the 1950s and 1960s to a range of 35 to 39 percent from the 1980s until the 2008 crisis, sales taxes and social security taxes, both of which are regressive were raised, further increasing inequality and feeding the flames of speculation.

⁴¹ In 2006, the top one percent of households received 22.5 percent of all pre-tax income (includes capital gains), the same percent as in 1929 (Piketty and Saez 2006).

⁴² In 1929, 90 percent of taxpayers had less disposable income than in 1922, whereas the top one percent of taxpayers had disposable income 63 percent greater (Livingston 2009: 38).

⁴³ The culture wars died out once the Great Depression refocused attention on the economic struggle for income and

jobs.

⁴⁴ However, a number of studies challenge the claim of a positive relationship between inequality and economic dynamism, finding instead that greater income inequality causes economies to grow more slowly (Alesina and Rodrik 1994; Easterly 2002; Persson and Tabellini 1994).

⁴⁵ Whereas the top one percent of households in 1929 received 22.5 percent of all pre-tax income (includes capital gains), they only received 9 percent by the late 1970s (the “Great Compression”) (Piketty and Saez 2006).