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A Brief History of the American Middle Class

Y. Datta[1*]

[1] Professor Emeritus, Northern KY University, Highland Heights, KY 41099, USA

[*] Y. Datta, Professor Emeritus, Northern KY University, Highland Heights, KY 41099, USA

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Abstract

The credit for the birth of the American middle class in 1914 goes to Henry Ford.

Reckless speculation in the New York Stock Market led to the Great Depression of 1929: the longest and most severe depression ever experienced by America, that led to an amazing level of unemployment that lasted till 1939.

Democrat Franklin D. Roosevelt, who was elected as President in 1933, instituted New Deal: a series of programs--the most important of which was the G.I. Bill.

The baby boom, increasing consumer income, affordability of cars and homes--coupled with the new interstate highway system—all worked together, that then led to a mass migration of the middle class from the inner cities to suburbia.

The years 1947-1973 are considered the golden years of America's middle class: an age the U.S. will never experience again. The foundation of this goldilocks economy was the social covenant of shared prosperity between big business and big labor.

The 1980-2008 period marks 'America in decline' largely because America took a sharp turn toward unfettered capitalism and greed.

This led to a massive growth of the Financial Services Industry.

Income inequality has steadily been increasing in America for 45 years from 1974-2018, and by 2007 it touched or exceeded the lofty heights of 1928.

A socio-economic class lifestyle profile of America includes three groups: The Upper Class, The Middle Class, and The Lower Class, each with two classes, making it a total of six.

Finally, a look into the forces that led to the stock market crash of 2008.

Keywords

Middle class, social covenant of shared prosperity, profit maximization, industrial commons, income inequality, massive growth of the financial sector, socio-economic class profile of America, credit default swaps.

1. Introduction

This is a long paper, so we have divided it into several sections:

Section I: Birth of America's Middle Class: 1914

Section II. The Great Depression of 1929 and the New Deal

Section III. The Golden Years of America's Middle Class: 1947-1973

Section IV. America in Decline: 1980-2008

Section V. Massive Growth of the Financial Services Industry

Section VI. Increasing Income Inequality in America: 1974-2018

Section VII. A Socio-economic Class Lifestyle Profile of America

Section VIII. Forces that Led to the Stock Market Crash of 2008

Section I: Birth of America's Middle Class: 1914

2. Henry Ford and the Birth of the American Middle Class

Henry Ford was *not* the first to build a modern-day automobile. That honor goes to Karl Benz of Germany, who got a patent in 1886 for a vehicle that ran on a gasoline-powered engine. In 1908 Ford launched the first *Model T* automobile. However, a change of monumental proportions occurred when Henry Ford introduced the world's *first moving* assembly line in 1914: a move that cut the Model T's assembly time from 12 hours to *just* 93 minutes (Cwiek, 2014).

However, there was a *downside* to this positive development. The new assembly line required *unskilled* workers who would perform the same *repetitive*, specialized tasks *all* day long, day in and day out. At that time, there was chronic *absenteeism* and *high* worker turnover. Thus, Ford gambled that *higher* wages would attract better, more reliable workers. So, he made an extraordinary offer to workers: $5 a day for eight hours of work, which works out to $120 in 2014 dollars. That was more than *double* the average factory wage at that time (Cwiek, 2014).

As it turned out, Ford's gamble was a total *success*. It led to a sharp *increase* in productivity at Ford, and the Ford Motor Co. *doubled* its profits in less than two years (*ibid*).

For American workers that was a *defining* moment of the 20th century (*ibid*).

There was a common belief, that one factor Henry Ford may have considered in his decision to double the wages of his factory workers was that they could then *afford* to buy the cars they made. This decision was a "game changer" because it greatly *expanded* the auto market (Cwiek, 2014).

And that is how the American *middle class* was *born*, and that led to the emergence of an economy that was driven by consumer *demand* (*ibid*).

Section II. The Great Depression of 1929 and the New Deal

3. The Great Depression of 1929

Throughout the 1920s, the U.S. economy expanded rapidly. As a result, America's total *wealth* between 1920 and 1929 more than *doubled*: a period called the "roaring twenties." (Note 1).

The New Yok Stock Exchange was the center of reckless *speculation*, where everyone—from millionaires to cooks and janitors—poured their savings into stocks which then led to a *rapid* expansion of the stock market reaching its *peak* in August 1929 (Note 1).

The result was the Great Depression of 1929 that was the *worst* economic downturn in the history of the industrialized world, lasting from 1929 to 1939 (Note 1).

It triggered fundamental changes in "economic institutions, macroeconomic policy, and economic theory." Although it originated in America, the Great Depression caused severe *decline* in output, acute *unemployment*, and sharp *deflation* in almost every country of the world (Note 2).

Furthermore, its social and cultural effects were *no* less consequential--primarily in America--where the Great Depression imposed the harshest misfortune faced by Americans since the Civil War (Note 2).

3.1 President Hoover: Government Not Responsible for the Economy

President Herbert Hoover, a Republication, believed that it was *not* the business of the government to directly intervene in the economy, and that it was *not* the responsibility of the government to create jobs or provide economic relief for the public (Note 1).

3.2 John Maynard Keynes' Theory

British economist spearheaded a *revolution* in economic thinking that *overturned* the then-prevailing idea that *free* markets would automatically provide full employment—that is, that everyone who wanted a job would have one as long as workers were flexible in their wage demands (Note 3).

4. Franklin D. Roosevelt and the New Deal

Franklin D. Roosevelt (FDR), a Democrat, was elected as President in 1933 (Note 4).

At the very outset he reassured the American public with this message of hope:

- "Let me assert my firm belief that the only thing we have to fear is *fear* itself" (*italics* added).

In some cities *unemployment* had reached astounding levels. By 1933, Toledo, Ohio's rate climbed up to 80%, and in Lowell, Massachusetts as high as 90% (Note 4).

Based on Keynesian economics (Note 5), the New Deal was a series of programs and projects that were implemented during the *Great Depression.*

During his tenure the following are FDR's major accomplishments (see Note 4):

- He asked Congress to end Prohibition so that it again became legal for Americans to buy beer and alcoholic drinks.

- He signed the Tennessee Valley Authority (TVA) Act into law that enabled the central government to build dams along the Tennessee River that controlled flooding and generated low-cost *hydroelectric* power.
- Under his leadership, Congress passed a law that *paid* commodity farmers (e.g., wheat, corn, etc.) to leave their fields *fallow*, in order to end agricultural *surpluses* and to *raise* commodity prices.
- The *Glass Steagall Act* was passed in 1933, which was designed to *separate* commercial banking from investment banking, to protect bank depositors from the *dangers* of banks indulging in *risky* investments and *speculation* (Datta, 2011).
- In 1935 FDR created the Works Progress Administration (WPA) to provide *jobs* for unemployed people.
- In 1935 FDR signed into law the *National Labor Relations Act*, also known as the Wagner Act, to monitor union elections and *prevent* management from treating their workers unfairly.
- Next FDR signed the *Social Security Act* of 1935 which guaranteed *pensions* to millions of Americans.
- He also set up a system of *unemployment insurance*, and stipulated that the government will help dependent *children* and the *disabled*.

4.1 The G.I. Bill

One of the most important legislations that FDR signed into law in 1944 was the G.I. Bill aimed at the returning WWII soldiers (veterans). It offered the following benefits for them (Note 6):

- Those who wanted to continue their college or vocational education, could do so tuition-*free* up to $500, and also be eligible for a cost-of-living stipend.
- The GI Bill *opened* the door of higher education to the American working class as *never* before. In 1947, veterans accounted for 49% of the college admissions.
- The bill provided $20 weekly *unemployment* benefit for veterans up to one year.
- The U.S. government *guaranteed* loans for veterans that enabled them to buy a home, business, or farm.
- *Medical care* was also an important part of the GI Bill. The government opened *new* hospitals for *veterans* and created the Department of Veteran Administration to manage them.
- By 1956 about *10 million* veterans had received benefits from the GI Bill.

4.2 G.I. Bill: Discrimination Against African Americans and Women

Although the benefits of G.I. Bill were offered to all veterans regardless of gender or race, some people found it easier to collect the benefits than others. Many African Americans and women faced *hurdles* to get loans for higher education. In some southern states they were steered toward *menial* jobs instead of college.

Even if African Americans received tuition loans, this did not help them much, because many colleges were *segregated*, especially in the south. Although African Americans in the North fared better, yet they

did far less well than their white compatriots.

Women, too, were the subject of *discrimination* in colleges because men universally received enrollment *preference*.

Local southern banks often refused to lend money to African Americans to buy a home even when the government backed the loan. As we have noted next, many suburban neighborhoods--like Levittown—did *not* allow African Americans to move to suburbia. Consequently, while the whites rushed to the suburbs, most African Americans remained *stuck* in the inner cities.

4.3 Levittown, New York

Levittown, New York is the *firs*t of seven large *low-cost suburban* housing developments started by William Levitt Co. for returning veterans after WW II. Levitt modeled production of these houses on *assembly* lines that made it possible to build a house in just *one* day. Standard Levittown houses featured a *tree* in the front yard, *white* picket fence, green lawns, and modern appliances. Within three hours after the sales first started in March 1947, 1400 houses had been sold (Note 7; Suddath, 2009).

These new communities offered an appealing *alternative* to *cramped* central city apartment living at a cost that was a *fraction* of the rental cost of these apartments (Note 7).

All of a sudden millions of veterans--based on the loans *guaranteed* by the U.S. government--were able to afford their *own* homes for the very *first* time (Suddath, 2009). These loans made it possible for millions of veterans to give up city life and *move* to *mass-produced* “cookie-cutter” homes in *suburbia* (Note 4).

4.4 Racial Discrimination Supported by U.S. Government

However, Levitt *refused* to sell Levittown homes to people of *color*. The Federal Home Administration (FHA) blatantly endorsed this discrimination by including *racial* covenants in each deed. And that made Levittown a *segregated* community approved by *none* other than the government of the United States (Note 7).

5. Migration of Middle Class from Inner Cities to Suburbs

Historians use the word “boom” to characterize many things about the 1950s: “the *booming* economy, the *booming* suburbs--and most of all--the so called “baby *boomers*.” The baby boom began in 1946 and by the time it tapered off in 1964, there were 77 million baby boomers (*italics* added; Note 8).

In 1956 President Eisenhower, a Republican, signed the Federal Highway Act that created a 46,000-mile “National System of Interstate and Defense Highways” (Note 9).

The number of private cars had gone up by just 3 million during the 1930s. However, by 1960 there were 62 million cars on the road: one for 1.8 adults (Levy, 1988, p. 50).

The baby boom, increasing consumer income, affordability of cars and homes--coupled with the new interstate highway system—all worked together that then led to a mass *migration* of the middle class from inner cities to suburbia (*ibid*).

5.1 How the Interstate Highway System Led to Decay of Inner Cities

When the Interstate Highway Act was first passed, most Americans supported it. However, soon the negative consequences of the roadway system began to become clear. The most damaging was the *harm* the roads were inflicting on the cities in their path. They *displaced* inner-city dwellers from their homes, and sliced communities in *half* (Note 9).

This led to the abandonment--and *decay*--of one city after another (*ibid*).

Section III. The Golden Years of America's Middle Class: 1947-1973

6. The Golden Years of America's Middle Class

The years 1947-1973 are considered the golden years of America's middle class: a golden age the U.S. will *never* experience again according to Gold (2017).

There are *three* major factors that made this *goldilocks* scenario possible:

- An *expanding* market for *basic durable* goods: both in the U.S., as well as Europe and Japan because their economies had been *devastated* during the war.
- A tight *oligopolistic* structure made it possible for the leading American companies to practice *cost-plus* pricing.
- Legislation under FDR provided big labor a "countervailing power" to big business.

By the end of World War II, there was a lot of *pent-up* demand for basic *durable* goods. This was further bolstered by the needs of Europe and Japan because their economies had been *devastated* during the war (Levy, 1988, p. 48; Datta, 1997).

For *eighteen* years from 1929 to 1946, America had gone through a period during which "material aspirations had been put on the *shelf*." During the Great Depression there was *no* income. During the war there was income but *no* consumer goods (Levy, 1988, p. 45, *italics* added).

If progress can be defined by material goods, then the fifties and sixties were the *golden* decades in American history. Within the space of a *single* generation, 1947 to 1973, the real U.S. Domestic Product (GDP) more than doubled--130% (Figure 1).

More importantly, Median Family Income went up a *whopping* 83% during the same period (Figure 1).

Jim Tankersley (2020), an economics reporter for *The New York Times*, points out that the economic boom after WW II was *not* just restricted to white men. African Americans, women, and immigrants, *too,* made *significant* gains until the 1970s (Newcomb, 2020).

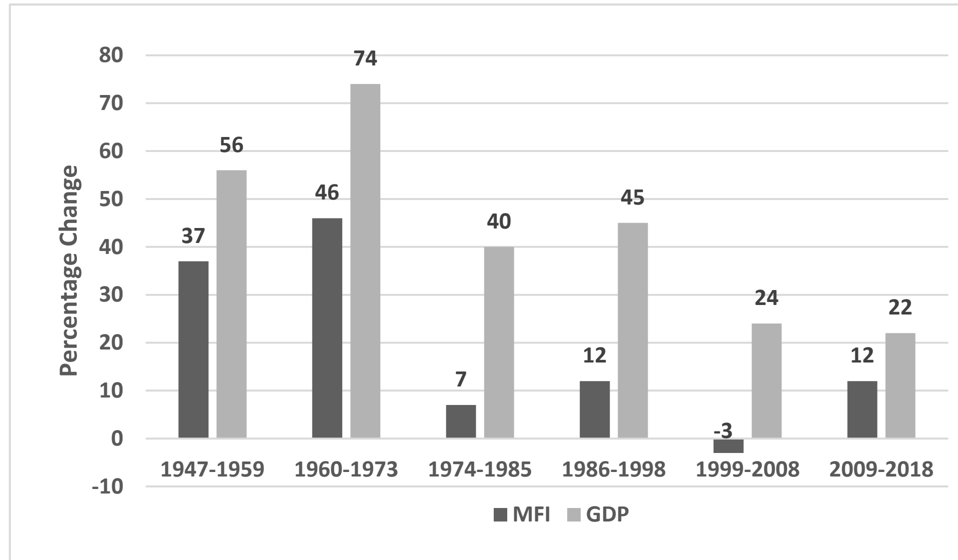

Figure 1. Percentage Change in Median Family Income (MFI) vs. Gross Domestic Product (GDP): 1947-2018

Sources:

Median Family Income:

- 1947-1998: *The State of Working America, 2006-2007* (Bernstein, Mishel, & Allegretto, 2007, Table 1.3).
- 1999-2008: *The Economic Report of the President* (2010), Table B-33.
- 2009-2017: *The Economic Report of the President* (2019), Table B-20.
- 2018: *The Economic Report of the President* (2020), Table B-20.

Gross Domestic Product:

- 1947-2018: https://www.thebalance.com/us-gdp-by-year-3305543

Consumer Price Index:

- 1913-2020: https://www.minneapolisfed.org/about-us/monetary-policy/inflation-calculator/consumer-price-index-1913-

After World War II, the U.S. came out of the war virtually *unscathed* (Levy, 1988, p. 48). At this time many major American industries were *bereft* of much competition—both domestic and foreign. A tight *oligopolistic* structure made it possible for the leading companies to practice *cost-plus* pricing that enabled them to pass on increasing costs to the customer, as mentioned above (Datta, 1997).

As indicated before, the *most* important piece of *labor* legislation in U.S. history was passed in 1935 under FDR: the National Labor Relations Act. During the post-war period, this legislation provided big labor a "*countervailing power*" to big business, with government acting as a referee (Datta, 2011).

7. The Social Covenant of Shared Prosperity Between Big Business and Big Labor

7.1 The Treaty of Detroit: UAW–GM Contract of 1950

In 1950 United Auto Workers Union (UAW) signed a long-term contract with General Motors (GM)--which Ford and Chrysler also later agreed to. This agreement was called the *Treaty of Detroit* and was negotiated under the leadership of President Truman, a Democrat. It was based on a framework of *shared prosperity* (Datta, 2011).

Its main features were: powerful unions, a high minimum wage, progressive taxation, and corporations providing health and retirement benefits (Datta, 2011).

This contract shaped labor-management relations for *decades* and became a *model* for many industries (Note 10).

One of the most *remarkable* features of the postwar period was that even *ordinary* Americans became members of the *middle class*. Thus, with so much *munificence* all around, an *unwritten* contract evolved between the large corporation and its employees (Datta, 1997).

The large corporations "virtually guaranteed job security, promotions and steady raises," and the employees, in return, would offer their loyalty, dedication, and commitment. This *social covenant* was based on the idea of *shared prosperity* and growth which fed the American belief: in the words of President Kennedy, that "a rising tide lifts all boats" (Datta, 1997).

The 1950s saw the rise of the *civil rights* movement. In a landmark decision of "Brown vs. Board of Education," the U.S. Supreme Court ruled in 1954 that "separate educational facilities" for black children were "inherently unequal." The ruling was the "first nail in *Jim Crow's* coffin" (Note 11, *italics* added).

President Johnson, a Democrat, initiated his "Great Society" program to address *poverty* and racial *injustice* in America. He developed a set of programs that would give *poor* people "a hand up, *not* a handout." In 1965 he signed the *Medicare* health care law for the elderly, and *Medicaid*, which helped the *low*-income people pay for their health care (Note 12).

President Johnson signed into law the Fair Housing Act of 1968 that *prohibited* discrimination concerning the sale, rental, and financing of housing based on race, religion, national origin or sex (Note 13, Levy, 1988, pp. 47-48).

7.2 OPEC Oil Embargo

In October 1973, OPEC (Note 14) imposed an oil embargo on America and other countries for providing military help to Israel in the Arab-Israeli war. In March 1974, the U.S. embargo was lifted. Nevertheless, price of crude oil still remained high, and by 1980 the price of crude oil was 10 times what it had been in 1973 (Note 15).

And that is how the post-war 26-year *golden* era of the middle class *ended.*

However, *in contrast*, during almost the next *half* century, median family income rose by just 0.6% per year!

Section IV. America in Decline: 1980-2008

8. Managing Our Way to Economic Decline

In 1980 *Harvard Business Review* (HBR) published an article with the above title that was authored by Profs. Hayes & Abernathy: both from the Harvard Business School. In 2007 HBR editors issued a *reprint* of the article with *new* editorial comments. That was the time when America was suffering from a marked *decline* in competitive vitality and economic health (Hayes & Abernathy, 2007).

The editors admit that the article was controversial when first published. However, Prof. Hayes points out that he was "struck by how *mainstream* its assertions and recommendations appear" *even* after 27 years (*ibid*, *italics* added).

At the end of the 1950s a *major* shift seems to have occurred in business principles and practices. This was the era when multi-divisional enterprises were spreading and the social science-oriented business schools shot into prominence (Johnson, 1992, chap. 2; Datta, 1998).

Hayes and Abernathy (2007) suggest that business schools engendered *pseudo*-professionalism that *downgraded* the importance of industry knowledge and "hands-on" expertise, and *venerated* financial and quantitative analysis (also Datta 1998). In Mintzberg's (1994) words, the idea that an effective strategy can be constructed by someone in an "ivory tower*"* is *totally* unrealistic (also Datta, 1998).

It was under this setting that American business became "unplugged from reality." American managers began to regard their businesses as a *portfolio* of income-generating *assets* to be "milked," "harvested," or treated as "stars" or "dogs." *Instead* of focusing on people, customers, and processes, American managers *shifted* their attention to costs, profits, and accounting relationships (Johnson, 1992, p. 31, chap. 2; Datta, 1998).

This new mind-set encouraged *risk aversion* and *short-run* behavior: an accountant's *short cut* to profits, with a focus on *cost reduction* rather than *long-term* concerns about innovation, quality, and customer satisfaction (Hamel & Prahalad, 1994, chap. 1; also, Datta, 1998).

Thus, *lower* quality and *lack* of innovation played a key role in the virtual disappearance of U.S. companies from the consumer electronics industry, and their loss of world dominance in such markets as automobiles, steel, and tires (Datta, 1997).

RCA failed to meet the Japanese challenge in color TV and VCRs because it considered this operation a *mature* business, and so treated it as a *cash cow*. To label a business as a "cash cow" is to say it is finished', it is not only demoralizing for the managers, staff, and workers, it also gives a *free ride* to the competition (Mintzberg, 1992). Thus, RCA—and GE—*handed* the Japanese with a virtual *monopoly* in the consumer electronics market (Hamel & Prahalad, 1989; also, Datta, 1998).

And it was this *momentous* philosophical shift—from substance *to* shadow—that has contributed so much to the American industrial decline (Hayes & Abernathy, 2007).

Hayes & Abernathy (2007) ask the question *why* such a large number of managers have moved so strongly to this *new* managerial orthodoxy? They suggest that this is because over the last 25 years there

has been a *substantial* increase in the percentage of *new* company presidents whose prime interest is in the *financial* and *legal* fields: *not* in production.

8.1 The Fall of an American Icon: General Motors (GM)

During the *earliest* years in the U.S. automobile industry, most improvements were *mechanical* in character (Data, 2010a)

However, GM's *failure* to develop an innovative air-cooled engine for Chevrolet in 1923, led GM's President, Alfred Sloan to adopt the strategy of "don't innovate." This mind-set became *ingrained* into general policy that would later dominate corporate thinking (Cray, 1980, p. 198; also, Datta, 2010a).

By the *end* of 1920, the industry saw fewer and fewer mechanical improvements. The "new and improved" models the American public expected from Detroit, were "new and improved" *only* by the "addition of *convenience* and the *dint* of advertising" (Cray, 1980, p. 246, *italics* added; also, Datta, 2010a).

So, Sloan instituted a policy of *annual* model change--a strategy of "planned obsolescence--" that became *standard* industry practice. It was instituted to *increase* demand by *inducing* customers to buy *new* cars more *frequently*, because the new models made the older ones *look* unfashionable, and therefore, undesirable (Cray, 1980, p. 235; also, Datta, 2010a).

For too long GM had pursued a notion of quality that was literally *skin* deep. GM's dominance of the auto industry allowed it to set the rules of the game that were anchored in *style*—an area GM had made a part of its *core* competence. GM was clearly the king when the competition consisted solely of the much weaker rivals: Ford and Chrysler.

However, GM found it was in a *different* league altogether when the Japanese and the Germans joined the competitive arena (Datta, 2010a).

So, it is *sad* to see that GM, an American icon, had to file for Chapter 11 bankruptcy in 2009. Now that it has come out of bankruptcy, we hope the new GM would hopefully have a bright future (*ibid*).

8.2 Merger Mania

The *financial* or legal mindset at the top, as mentioned above, created an atmosphere that encouraged diversification *away* from core technologies and markets. So, it is *not* surprising that there was a merger mania--with about 80 mergers in 1978 and 100 in 1979--with assets more than $100 million each. Ironically, most of these mergers *failed* to generate economic benefits for the stockholders (Hayes & Abernathy, 2007).

9. The Pension Fund Revolution: From Stakeholder to Stockholder Theory

The *stakeholder* theory was first proposed in 1932 by Berle & Means (1968). According to Drucker (1991, p. 114, *italics* added), this is "arguably the *most* influential book in U.S. business history." Berle & Means argued that the traditional "owners"--the nineteenth century entrepreneurs--had been *displaced* by a faceless horde of investors who had "exchanged control for liquidity," and who were concerned *only* with *short-term* profit.

So, Berle & Means asserted that the *claims* of shareholders' ownership, their passive property rights, and the claims of management control must *yield* before the larger interests of *society*. Thus, they advocated a *pluralistic* view of the large publicly-owned corporation in which top management is charged with "*balancing* a variety of claims by various groups in the community and assigning to each a portion of the income stream on the basis of *public* policy rather than private cupidity" (Datta, 1997, *italics* added).

Ralph Cordiner, then CEO of General Electric, made a call for a similar philosophy. He said that the top management of a large publicly-held corporation was a *"trustee"* of the enterprise whose responsibility was to manage the corporation "in the best-*balanced* interest of shareholders, customers, employees, suppliers, and plant community cities" (Drucker, 1991, p. 108, *italics* added).

Cordiner's slogan soon became quite popular, and many American corporations incorporated it in their "corporate philosophy" statements (Drucker, 1987, p. 16).

However, Drucker (1991) points out that big business under Cordiner-style professional management did *not* perform well in the market: whether measured by quality, market share, innovation, and even return on investment. From a peak of about 10 percent in 1965, the average after-tax profit rate of U.S. nonfinancial corporations plummeted to *less* than 6 percent, during the second half of the 1970s (Datta, 1997).

As already mentioned, U.S. companies virtually *disappeared* from the consumer electronics industry, and they *lost* their world dominance in such markets as automobiles, steel and tires.

Drucker (1991) reports, that the *most* powerful setback to Cordiner-style management was the emergence of the *hostile-takeover* movement of the 1980s which led to the *downfall* of many managers who subscribed to this style. As a result, the survivors were *forced* to "change drastically how they manage, or at least to change their rhetoric."

Drucker (1991) declares that *no* "top management I know now claims to run its business as a 'trustee' for the 'best balanced interest' of 'stakeholders.'" Today, adds Drucker, "nearly *all* CEOs of large U.S. companies proclaim that they run their enterprises 'in the interests of the shareholders,' and 'to maximize shareholder value'" (*ibid*, pp. 108-109, *italics* added; also, Datta, 1997).

According to Drucker (1991; also, Datta, 1997), the *pension funds* have been the major driving force behind this change. The rise of this new class of investors has been the result of a quiet *revolution* that has taken place in American business: the *shift* in ownership of the large publicly-held corporation *to* representatives of the *employee* class, that is, pension funds and mutual funds.

In 1991, adds Drucker, these institutional investors controlled about 40 percent of publicly-traded common stock of U.S. firms. The U.S. security laws, with their emphasis on *liquidity*, require institutional investors to *diversify* their portfolios. As a result, the ownership of company stockholdings is increasingly becoming *fragmented* (*ibid*).

With a focus on *liquidity*, the trustees of institutional funds therefore tend to act more as *short-term* investors than long-term owners (Bhide, 1994; also, Datta, 1997).

10. America Takes a Sharp Turn toward Unfettered Capitalism—and Greed

In an article published in *The New York Times* fifty years ago, Milton Friedman (1970), Professor of Economics at the University of Chicago—who later won a Nobel Prize--declared that the *social* responsibility of a business is to maximize its *profits*. He asserted that a company had *no* "social responsibility" to the public or society, but *only* to its shareholders (Datta, 2021).

However, as it turned out, profit, maximization is *neither* good for society, *nor* even for shareholders (*ibid*).

As the following discussion shows, the publication of the Friedman doctrine represented a *turning* point when America took a sharp tilt toward *unfettered* capitalism—and *greed*. And this is the doctrine that has guided economists and business leaders over the last *fifty* years (Datta, 2021).

In a brilliant essay, Prof. Robert Anthony of Harvard Business School (1960) argued that Friedman's theory *of profit maximization* is too difficult, too unrealistic--and *immoral* (Datta, 2021).

Anthony (1960) says that profit maximization requires the businessman to use every *trick* in the book to do the following (Datta, 2021):

- Keep wages and fringe benefits *low*
- To *extract* every possible dollar from the consumer
- To sell as *low* a quality merchandise as he can legally fool the customer into buying
- To use income *solely* for the benefits of the stockholder
- To *disown* any responsibility to the community
- To finagle the *lowest* possible price from his vendors
- The "long run" is a *long way off* and its effect on current decisions is unclear
- A businessman's conscience and *ethical* considerations are *irrelevant*

And to all of the above, we can add: laying-off workers, closing plants, spinning off divisions, and *outsourcing* production to foreign countries with low wages, such as China (Datta, 2021).

The Friedman doctrine, as outlined above, was so far off the *prevailing* business *practice* and *ethos*, that

Anthony then *boldly* declared back in 1960, that businessmen could *not* maximize (profits) if they wanted to: and would *not* want to even if they could (*ibid*).

Little did he realize that the *grip* of the Friedman doctrine turned out to be so *powerful* that it set in motion the "*unraveling* of all the old *norms* concerning the *loyalty* and *decency* of businesses towards employees" (Andersen, 2020, p. 204, *italics* added).

This shift toward maximizing *shareholder* value—grounded in *short-term* profit *maximization*--has taken several forms:

- Downsizing
- Outsourcing: Ceding the Industrial Commons to the Competition
- Loss of Labor-Union Power
- Massive Transfer of Economic Risk to the Middle Class

- CEO Compensation Going Through the Roof
- Increasing Economic Inequality
- Massive Deregulation of Financial Markets

10.1 American Companies Pursue Downsizing to Become "Lean and Mean"

Downsizing in the *past* was considered to be a symbol of *decline*, and therefore had a *negative* connotation. It used to be a mark of *shame* to fire workers on a mass scale. However, since the early 1990s the balance has swung radically *toward* the shareholders. Today, a CEO would be embarrassed to admit that he sacrificed profits to protect employees or a community. Wall Street loves it because such actions often result in boosting—usually for a *short* period—the price of a company's stock (Datta, 1997).

Even healthy companies began laying off workers. For example, IBM abandoned its proud heritage of a promise of permanent employment. Beginning in 1990, it fired 41% of its labor force in *five* years (Andersen, 2020, pp. 150, 204).

11. Outsourcing: Ceding the Industrial Commons to the Competition (Note 16)

Pisano and Shih (2009) argue that America's economic decline of the 1980s and early 1990s *didn't* really disappear. "It was just *hidden* during the *bubble* years behind a *mirage* of prosperity, and all the while the country's industrial base continued to *erode*" (*italics* added).

Thanks, in a large measure to the Friedman doctrine, for decades, U.S. companies have been *outsourcing* manufacturing to *save* costs on the belief that manufacturing *at home* held *no* competitive advantage. But that has been a *disaster*, because *today's* low-value manufacturing operations contain the *seeds* of *tomorrow's* innovative new products. What those companies have been *ceding* is the country's *industrial commons*--that is, the *collective* operational capabilities that support *new* product and process development in the U.S. industrial sector. Consequently, America has *lost* not only the ability to develop and manufacture *high-tech* products--like televisions, memory chips, and laptops--but also the *expertise* to produce *emerging* hot products like the *Kindle e-reader*, *high-end servers*, *solar panels*, and the *batteries* that will power the next generation of automobiles (*ibid*).

Centuries ago, "the commons" referred to the *land* where *animals* belonging to people in the *community* would graze. As the name implies, the commons did *not* belong to any one farmer. *All* were better off for having access to it (*ibid*).

Industries, *too*, have commons. A *foundation* for innovation and competitiveness, *commons* can include R&D know-how, advanced process development, engineering skills, and manufacturing competencies related to a *specific* technology (*ibid*).

To *rebuild* the commons--and *restore* its wealth-generating machine--will call for government *and* industry in America to make *two* radical changes: (1) The government *must* change the way it supports *basic* and *applied* scientific research, to promote the broad *collaboration* with business and academia, needed to *address* society's big problems, (2) Corporate management practices and governance

structures *must* also be overhauled so they no longer *exaggerate* the payoffs of outsourcing production on the one hand, nor *discount* its dangers on the other. Moreover, they should also *stop* cutting investments in R&D (*ibid*).

11.1 President Biden Signs the CHIPS and Science Act

Trillion-dollar firms, like Amazon.com, Google, and Apple would not exist it wasn't for the microchips. We have now realized how important they were to American industry when we could *not* produce enough *cars* because of their shortage (Note 17).

So, on August 9, 2022 President Biden signed the CHIPS and Science Act. The new law will provide $52 billion to boost U.S. semiconductor production, with $170 billion more for scientific research and innovation (Note 18).

12. Loss of Labor-Union Power

In 1981 President Ronald Reagan, a Republican, *fired* all striking air traffic controllers and then replaced them with new employees (Andersen, 2020, p. 202).

From 1973 to 2007, union membership dropped drastically from 34% to 8% for men, and from 16% to 6% for women (Datta, 2011). In 2020 the percent of wage and salary workers who were members of a union was 10.8 percent (Note 19).

As mentioned earlier, the 1950 *Treaty of Detroit* was based on the idea of *shared* prosperity between management and labor. However, after 1980, a *new* institutional norm, known as the *Washington Consensus*, emerged *weakening* the earlier gains by the unions. The grounding principal of this new norm was *deregulation* and *privatization*—what President George W. Bush called an 'ownership society.' However, skeptics say that what it *really* meant was YOYO: that "*you are on your own*" (Datta, 2011).

12.1 Employees Face Constant Monitoring

For decades American employers have been getting the *better* of their employees (Leonhardt, 2022a). As a result:

- "Companies have been getting *bigger*, giving them *greater* ability to *set* prices and wages. Labor unions have been *shrinking*, leaving workers with *less* ability to negotiate for raises. And *court* rulings, especially from the Supreme Court, have tended to *side* with companies over workers or regulators" (*italics* added).

The share of corporate profits of American economy's output has almost *doubled* since the mid-1970s, while the share going to the workers has gone *down*. Previously stock prices and family income closely *tracked* each other. But now they do *not* (*ibid*).

Companies employ *technology*-based monitoring system--that often has a "Big Brother" quality—that tracks workers' keystrokes *second-by-second* (*ibid*).

Monitoring of employees in *lower*-paying jobs is already quite common, e.g., Amazon.com, Kroger, UPS and millions of others. However, now digital-productivity *monitoring* is spreading among *white-collar* jobs that call for *graduate* degrees (*ibid*).

12.2 Massive Transfer of Economic Risk to the Middle Class

During the 25-year period from 1982-2007, the number of American workers--and their dependents--who did *not* have health insurance began to *climb* steadily, as corporations increasingly *cut* their coverage. During a two-year span over 80 million adults and children found themselves at some time *without* the protection against catastrophic health costs (Hacker, 2007: 67; Datta, 2011).

Hacker (2007: 67-68) points out that around early eighties, 83 % of medium and large firms provided *traditional* "defined-benefit" (DB) pension plans. He then goes on to say (also Datta, 2011; Andersen, 2020, p. 204):

- [This is a] *massive* transfer of economic risk from the *broad* structures of insurance, both corporate and governmental, onto the *fragile* balance sheets of American families. This *transformation*, which I call "the great *risk* shift," is the *defining* feature of the contemporary economy, as *important* as the shift from agriculture to industry a century ago (*italics* added).

In 2017 only 16% of *Fortune 500* companies offered a DB plan to their new hires (Barney, 2018).

12.3 CEO Compensation Going through the Roof

An American CEO's pay went up from 42-times the average pay of a blue-collar worker in 1980, to 343-times the median pay of a worker in 2010—by far the widest gap in the world (Datta, 2011).

In 2017 this gap widened even further to 361-times more money than the average rank-and-file worker (Note 20).

Section V. Massive Growth of the Financial Services Industry

13. GE's "Neutron Jack" and Financializing of America

For decades after World War II, big business *bent over* backward to distribute their profits *widely*. In its 1953 annual report, General Electric (GE) proudly *bragged* about how much it was paying its *workers*, how its *suppliers* were benefiting, and even how much it paid the government in *taxes* (Leonhardt, 2022b).

However, that state of affairs changed *dramatically* when Jack Welch joined GE as CEO in 1981, and ran it for the next two decades (*ibid*).

David Gelles, a *New York Times* reporter, has been interviewing CEOs for years. In his book on Jack Welch (2022), he says that Welch became a *role* model for many CEOs, who began *imitating* him (Leonhardt, 2022b).

As mentioned earlier, the publication of the Friedman doctrine in 1970 represented a *turning* point when America took a sharp turn toward *unfettered* capitalism—and *greed*.

One person who enthusiastically *embraced* this doctrine was Jack Welch (Leonhardt, 2022b).

Welch was *ferociously* ambitious and competitive, with a *ruthlessness* that corporate America hadn't seen before. And with this *aggressive* mindset, this is what he accomplished for the next twenty years:

- "Under Welch, G.E. unleashed a wave of *mass* layoffs and factory *closures* that other companies *followed*. The trend helped *destabilize* the American *middle class*. Profits began flowing *not* back to workers in the form of higher wages, but to *big investors* in the form of stock buybacks. And G.E. began doing everything it could to pay as *little* in taxes as possible" (*ibid*, *italics* added).

Under the rule of Jack Welch, *one* out of ten employees were routinely *fired* every year *no* matter what. Welch's focus on cost cutting, offshoring, and *ruthless* personnel management earned him the nickname of "neutron" Jack" (Note 21).

Another step he took to *reduce* costs was to drastically *cut back* on research and development (Andersen 2020, p. 150; Leonhardt, 2022b).

An important *legacy* of Welch was that he *transformed* GE from a manufacturing to a largely *financial services* company (Andersen, 2020, p. 150; Leonhardt, 2022b).

In Welch's 20 years as CEO, GE's market value grew from $12 billion to $410 billion in 2001, making him one of the most *famous* corporate leaders of his time (Note 21; Leonhardt, 2022b).

However, these good times did *not* last very long. As of August 2022, General Electric's market cap had sharply *declined* to $83 Billion (Note 22).

The enormous financing business Welch built almost *toppled* GE during the 2008 financial crisis, requiring a *bailout* from legendary investor Warren Buffett (Note 23).

A similar fate greeted *dozens* of other companies where Welch disciples tried to imitate his playbook, such as Home Depot and Albertsons (Leonhardt, 2022b).

14. Friedman Doctrine Leads to Massive Deregulation of Financial Markets

The stock market crash of 1907 was a *precursor* to the Great Depression of 1929. During the early part of the 20th century in America, people lined up at betting parlors, called "bucket shops," to place *bets* on whether the price of stocks would go up or down: *without* actually owning the stock. It was this unregulated *speculation* that led to the stock market's *meltdown* in 1907 (Datta, 2011).

So, *states* all over the country *outlawed* this *gambling* activity which became a *felony* after the law became effective (*ibid*).

Although President Reagan was the major driving force toward deregulation during the 1980s, President Clinton--a Democrat--*too*, played an important role in *deregulating* financial markets. Amazingly, he *signed* the *Commodity Futures Modernization Act* (CFMA) of 2000, which now *allowed* investors to *bet* on securities they did *not* own. Thus, CFMA *rolled back* the *gambling* activity that was *illegal* for almost the entire twentieth century, as mentioned above (Datta, 2011).

Earlier, in 1999 President Clinton had signed into law the *Financial Services Modernization Act* which *repealed* the *Glass-Steagall Act* (GSA) of 1933. In the aftermath of the Great Depression of 1929, GSA was designed to *separate* commercial banking from investment banking to *protect* bank *depositors* from the dangers of bankers indulging in *risky* investments and *speculation* (Datta, 2011).

15. Why Did Democrats Embrace Massive Deregulation of the Financial Industry?

Major economic changes, such as the *shift* from an agricultural to industrial economy, or from an industrial to a post-industrial economy, produce winners and losers (Witko, 2016).

Clear *winners* in the age of *financialization* are the financial-industry managers, and stockholders, who have seen their incomes grow much *faster* than other skilled professionals. Furthermore, corporate managers and wealthy investors also see their incomes *increase* when *stock* prices rise (*ibid*).

But the *losers* were the *poor* and the *working class* who have *neither* the capital *nor* the expertise to take advantage of new investment opportunities. This group suffers *disproportionately* from *layoffs* or *reductions* in salary and benefits: actions firms employ to keep *profit* margins and stock prices *high*. The working people also carry *most* of the growing *debt* when wages and benefits are *stagnant* (*ibid*).

Wall Street and American banks have traditionally engaged in *lobbying* and *funding* campaigns for candidates from the *Republican* Party. On the other hand, *working-class* and *lower-income* groups have historically relied on *labor unions* and the *Democratic* Party to *defend* their interests (*ibid*).

In an *intriguing* revelation, Witko (2016) says that, beginning the 1980s, Democrats started to *side* with the *banks* and the *Republican* Party in *promoting* financial deregulation. This is clearly evident in the Clinton administration's support for the *Financial Services Modernization Act* of 1999, which *repealed* a number of Depression-era regulations, such as the *Glass-Steagall Act* (GSA) of 1933, as mentioned above.

As the power of organized labor *declined*, and the Democratic Party became more heterogeneous, the Democrats *no* longer put a "brake" on the financial industry's growth. At the same time, Democrats *stopped* helping such economic sectors as construction and manufacturing (*ibid*).

16. How Massive Financial Deregulation Led to Rapid Growth of Financial Industry

As mentioned earlier, the business leaders enthusiastically *embraced* the Friedman doctrine with a focus on maximizing *short-run* profits, and increasing *shareholder* value. This turned out to be a *bonanza* for Wall Street and accelerated the growth of the financial services industry.

As mentioned in Chapter 11, one event that further *accelerated* the *expansion* of the financial services industry is the *transformation of* GE from a manufacturing to a largely *financial services* company: thanks to Jack Welch.

The GDP share of the U.S. financial industry—finance and insurance—tripled since 1947 to 8.4% in 2010 (Datta, 2011). In 2018 this share declined slightly to 7.4% (Note 24).

In contrast, between 1987 and 2010 the industry's before-tax profits as a percentage of total domestic business profits averaged more than *three* times as much at 27% (Datta, 2011).

In 2016 this figure stood at 28.4% (Note 25).

17. IMF: American Financial Sector's Vast Size Slowing U.S. Economic Growth

Leading economists from International Monetary Fund (IMF) warn that "the American financial sector has become so *large* that it was *slowing* economic growth (Newcomb, 2020, *italics* added).

John Bogle has provided the following insight into how enormously profitable the U.S. financial sector is (Datta 2011):

- It is the *largest* profit-making sector in America.
- It makes *more* money than our energy and healthcare companies.
- It makes *almost* twice as much as technology companies, and *twice* as much as the manufacturing sector.

Finally, Bogle adds that we have become a *financial* economy which has *overwhelmed* the productive economy to the detriment of investors, and the detriment of our society (*ibid*).

In a lecture in 1984 on the *efficiency* of America's financial system, Nobel Laureate James Tobin said: (Andersen, 2020, pp. 168-169):

- "That the financial *tail* was *wagging* our financial dog. We are throwing *more* and more of our resources, including the cream of our *youth*, into *financial* activities *remote* from the production of goods and services" and expressed his *dismay* at the "*casino* aspects of our financial markets" (*italics* added).
- "I suspect the immense power of the *computer* is being harnessed to the *paper* economy, *not* to do the same transactions more economically, but to *balloon* the quantity and variety of financial exchanges…facilitating nth-degree *speculation* which is short-sighted and inefficient" (*italics* added).
- "Very *little* of the work done by the securities industry…has to do with the financing of *real* investment…"

Section VI. Increasing Income Inequality in America: 1974-2018

18. Median Family Income Virtually Flat for Almost a Half Century

The middle class has been undergoing a relentless economic *squeeze* since 1974. For 45 years--between 1974 and 2018--the U.S. gross domestic product (*GDP*) grew by what amounted to a yearly average of 2.9%. Unbelievably, however—and in sharp *contrast*-- the *median* family income has literally been *stagnant* for almost a half century with a yearly average growth rate of a *mere* 0.6% (Figure 1).

19. Immigrants, Women, and Blacks: Economic Progress Closely Tied to U.S. Economy's Health

Tankersley (2020) rejects, what he considers a *myth*, the notion that the Civil Rights Act created a level playing field for Blacks in America. Initially, the law did lead to *significant* improvements in their lives during the 1970s and 1980s. However, after this, there were several *setbacks* to this progress. For example, the Reagan administration *dismantled* anti-discrimination programs. Another *negative* factor that hindered this progress was the mass *incarceration* of young Black men (Newcomb, 2020).

Since the 1970s, economic progress for Blacks has *declined* relative to whites. *White men* without a college degree had wealth that was *eight* times more than that of Black men (*ibid*).

The income for *all* Americans with only a high-school diploma, went down 12.3 percent from 1979 to 2018.

Tankersley further adds that the news media has focused *excessively* on the plight of *white* men *without* a college degree, *ignoring* the fact that women and minorities, *too*, wrestle with low wages, disappearing benefits, and rising health-care costs (*ibid*).

Tankersley strongly opposes the Trump administration's relentless *assault* on immigration. He says numerous studies have shown that *innovation* and *job creation* are closely associated with a *large* presence of *immigrants* with creative ideas (*ibid*).

While women's incomes have *stagnated* over the last 40 years, yet their contribution to the American economy are *noteworthy*. Women are "*more* focused than men on leveraging innovative technologies to solve *large* social problems like chronic disease or climate change" (*italics* added). Yet, economic success of women does *not* come at the expense of men. Thus, *increasing* gender diversity in the economy improves growth and productivity of *both* men and women (*ibid*).

20. Income Inequality Has Now Reached the Lofty Heights of 1928

The highest concentration of income in the U.S. occurred during the 1920s which culminated in the *Great Depression* of 1929 (Krugman, 2007: 16; Datta, 2011).

Income inequality in America has now run a full circle, and has now *touched or* even *exceeded* the dizzying heights of income recorded in 1928 (Table 1; Datta, 2011).

Table 1 contains a comparison of *pre-tax* income of the top U.S. earners: 99th percentile (top 1%), 99-99.5th percentile (the *bottom* half of the 99-100th percentile), 99.5-100th (the *top* half of the 99-100th percentile), and 99.99-100th percentile (the top 0.01%). This data is for 1928—the year *before* the Great Depression of 1929-- vs. 2007, the year *before* the Great Recession of 2008, and 2017.

Table 1. U.S. Pre-tax Income Share: 1928 vs. 2007, 2017

Year	99th percentile	99-99.5th percentile	99.5-100th percentile	99.99-100th percentile
	Top 1%	**Bottom half of top 1%**	**Upper half of top 1%**	**Top 0.01%**
1928	**23.94**	**4.54**	**19.40**	5.02
2007	23.50	4.19	19.31	**6.04**
2017	21.96	4.32	17.63	**5.28**

From: "Income Inequality in the United States, 1913-1998" by T. Piketty and E. Saez, *Quarterly Journal of Economics*, 118(1), 2003, 1-39 (Longer updated version published in A.B. Atkinson and T. Piketty eds., Oxford University Press, 2007) (Tables and Figures Updated to 2018 in Excel format, February 2020). This updated is from TabFig2018, Table A3 available at: https://eml.berkeley.edu/~saez/

One can clearly see that the income-share of the top 0.01% for 2007 and 2017--**6.04% and 5.28%**, respectively**--***surpassed* the *5.02* % share for 1928. While, technically, the corresponding 2007 scores for the top 0.5%, and the top 1% did not equal their 1928 counterparts, yet they *did* come very close to the towering heights of 1928.

21. The Top 0.01% Are a Class by Themselves

It is no secret that the gap between the rich and everyone else has been getting wider. Yet the extent to which the richest are leaving *even* the rich far *behind*, is *not* widely known (Datta, 2011).

Table 2 shows pre-tax income data for the top 5% earners. The data shows that the *average* income of the top 0.01% was 125.2 times that for the top 5%; 60 times that for the top 1-0.5%; 30.7 times vs. the top 0.5-0.1%; and 8.3 times the top 0.1-0.01%.

Thus, this evidence clearly demonstrates that the top 0.01%—about 17,000 families in 2018 (Table 2)--are in a *league* of their own.

Table 2. Threshold and Average Pre-tax Incomes of top 5% U.S. Families (including capital gains) 2018

Percentile Threshold	Income Threshold	Income Groups	Number of families	Av. Income of each group	Av. income top .01%Av. Income/Av. other groups
Top 5%	$198,350	Top 5-1%	6,916,280	$282,279	125.2 times
Top 1%	$486,340	Top 1-0.5%	864,535	$587,823	60.0 times
Top .5%	$748,040	Top 0.5-0.1%	691,628	$1,151,262	30.7 times
Top .1%	$2,22,1000	Top 0.1-0.01%	155,616	$4,245,467	8.3 times
Top .01%	$11,797,000	Top 0.01%	17,291	$35,299,254	

From TabFig2018, Table 0 available at: Piketty & Saez (2003). https://eml.berkeley.edu/~saez/

22. Top 0.5%: America's Upper Class

In Table 1 we saw that in 2007 income inequality in America almost *equaled* or *exceeded* the lofty heights of 1928. However, this table contains another *important* piece of insight. And that is that while the *bottom* half of the top 1% could muster only a 4.19% income share, the *upper* half of the top1% had a score of 19.31%: 4.6 times as large.

From this data it is clear that the upper and lower halves of the top 1% belong to two very *different* neighborhoods. Next, we present Table 3 which shows that while the *former* represents the "Upper Class," the *latter* embraces the *highest* earners among the "Upper Middle Class."

Table 3. An Economic Class Structure of America: 2017

Broad Income Groups	Percentile	Economic Class	Lifestyle Profile	Percentile	Income Threshold
The Upper Class	Top 0.5%	*The Super Rich*	*"Masters of the Universe"*	Top 0.01%	$11,797,000
		The Very Rich	*"Conspicuous Consumption"*	Top 0.1-.01%	$2,221,000
		The Rich		Top 0.5-0.1%	$748,040
The Middle Class	40-99.5%	*The Upper Middle Class*	*"Cultured Affluence"*	80-99.5%	$127,144
		The Traditional Middle Class	*From "Keeping up with the Joneses" to "Good quality Public Schools"*	40-80%	$48,002
The Lower Class	Bottom 40%	*The "Near Poor"*	*"Just Making It"*	20-40%	$24,913
		The Poor	*"Survival"*	Bottom 20%	

Note. The threshold income data for the top 0.5-0.01% is from Table 2.

The threshold income data for the "Near Poor Class" class, the "Traditional Middle Class," and the "Upper Middle Class from: Average, Median, Top 1% Household Income Percentiles (2018) - DQYDJ

23. Bottom 0.5% is America's Upper Middle Class

William Domhoff (2011a), professor at the University of California at Santa Cruz, also supports our position that the *upper* class begins at the 99.5th percentile. He says that the 99-99.5th percentile largely includes "physicians, attorneys, upper middle management, and small business people who have done well (Datta, 2011).

24. Definition of Middle-Class Income

Levy (1988: 206) says that *any* definition of a "middle-class income" is *arbitrary*. One way to visualize middle class is the *minimum* annual income necessary "to fulfill the *middle-class dream*," i.e., a middle-class standard of living. According to a survey, the *middle-class dream* means having a good job, being able to retire in security, owning a home, having affordable health care, and a better future for children (Datta, 2011).

He points out that prior to 1973, when incomes were going up this purchasing-power definition was identical to being in the *middle* of the income distribution. However, from 1973 the two definitions started to diverge, and occupying the middle of the distribution no longer ensured a middle-class standard of living (also Datta, 2011).

Levy's (1988: 206) estimate to fulfill the middle-class dream in 1984 was at-least $30,000. The

percentage of a family earning $30,000 or more (in 1984 dollars) declined from 51% in 1973 to 45% in 1984, even though an increasing proportion of wives were entering the labor force.

In 2018, too, this percentage was 45%.

Section VII. A Socio-economic Class Lifestyle Profile of America

25. A Socio-economic Class Lifestyle Profile of America

Republicans and the conservatives believe in a *myth* that America is a classless society. For example, according to the former President George Walker Bush, that while class is "for European democracies," it is *not* for America, and that we "are *not* going to be divided by class" (Datta, 2011, *italics* added).

In 1997, Irving Kristol, a neoconservative intellectual, wrote an article in *The Wall Street Journal*, titled: "Income Inequality without Class Conflict." He argued that we shouldn't worry about income inequality, because we had *social* equality. As an example, he said that "in all of our major cities, there is not a single restaurant where a CEO can lunch or dine with the absolute assurance that he will not run into his secretary" (Krugman, 2007, p. 245; Datta, 2011).

Krugman says that Kristol was actually acknowledging that "income inequality *would* be a problem *if* it led to social inequality." Krugman then goes on to say (*ibid):*

- In the real world, income inequality *does* lead to social inequality. "Kristol's *fantasy* of a world in which the rich live just like you and me, and nobody feels socially inferior, bears *no* resemblance to the real world we live in"

In Table 3 we present a *socio-economic* class *lifestyle* profile of America. It shows *three* broad groups "The Lower Class," "The Middle Class," and "The Upper Class": each with *two* classes thus making it a total of *six* (Datta, 2011).

25.1 "The Poor Class"

At the "bottom of the pyramid" (Note 26), this class consists of those who have *minimum-wage* jobs *without* benefits, and rely on government welfare programs and non-profit charity organizations.

It occupies the *bottom* 20% of U.S. Households with the *top* annual income of $24,913: a figure that closely matches the 2018 *poverty* guideline of $25,100 for a family of four (Note 27; Datta, 2011).

The best way to describe its *lifestyle* is "*Survival*" (*ibid*).

25.2 "The Near Poor Class"

Next in line, this class falls in the 20-40th percentile with an annual income between $24,913 and $48,002. Clerical, pink, and blue-collar workers, with *low* job security typically belong to this group (Datta, 2011). Its *lifestyle* can very appropriately be characterized as "*Just Making It*" (*ibid*).

25.3 "The Traditional Middle Class"

This class is next up the ladder occupying the 40-80th percentile with a yearly income between $48,002 and $127,144. Members of this class generally include college professors, school teachers, police officers, fire fighters, government bureaucrats, nurses, truck drivers, plumbers, skilled workers, farmers,

and small-business owners (*ibid*).

The best way to visualize its *lifestyle* is: “From keeping up with the Joneses” *to* “Good *quality* public schools” (*ibid*).

25.4 “The Upper Middle Class”

This class is next in line. It inhabits the 80-99.5th income percentile with an annual income between $127,144 and $748,040. Members of upper middle management, physicians, dentists, attorneys, small business owners, engineers, scientists, accountants, architects, and professors from top universities are usually the kind of people who belong to this group (*ibid*).

A good way to describe its lifestyle is: “*Cultured Affluence* (*ibid*).

25.5 “The Very Rich/ The Rich Class”

Next on the income hierarchy, this class is a resident of the top 0.5-0.01th percentile, with an annual income between $748,040 and $11,797,000. It includes CEOs of major corporations, business owners, top movie stars, singers, and athletes; top professionals, investment bankers, mutual fund managers, entrepreneurs, and inheritors (*ibid*).

Its *lifestyle* can appropriately be described as: “*Conspicuous Consumption*.”

25.6 “The Super Rich Class”

This class is at the very *top* of the pyramid. It is an occupant of the 0.01th percentile with an annual income of $11,797,000 *and* above. It includes hedge fund managers, CEOs of investment banks, private equity partners, real estate tycoons, and innovators (*ibid*).

It has earned the *lifestyle* title of “*The Masters of the Universe*”: a term made famous by Tom Wolfe (Krugman, 1994: 138; Datta, 2011).

26. Extraordinary Tax Breaks for the Rich

- One reason behind the *sharp* increase in 2003 in the share of capital gains is due to a drastic *reduction* in capital gains tax on assets—held *more* than a year—to a flat rate of 15% for taxpayers with the marginal tax rates of 25 to 35%. Consequently, the CEOs are now getting much *more* in stock awards and stock options than in salary (Note 28).
- Hedge Fund investment managers who earn *billions* of dollars from their daily *labors* are allowed to classify their income as “carried interest,” thereby getting a *bargain* 15% capital-gains tax rate (Note 29).
- The rich can also *escape* tax on an asset’s *appreciated* value by *not* selling it. They can pass on investments to their heirs with a so-called “step up in basis.” Thus, if the heirs sell the asset, they wouldn’t pay taxes on gains that accrued over the original owner’s lifetime (Note 28).

27. How Members of the Upper Class Earn Their Income?

An investment manager who works with wealthy clients--and who understandably wants to remain anonymous--makes an *important* distinction between those in the *lower* half of the top 1% and those in

the *upper* half. The *lower* half represents the very *top* earners in the Upper Middle Class (Table 3), that mainly includes physicians, attorneys, upper middle management, and small business owners. Those in the *upper* half of the top 1% are likely to be connected to financial services industry, real estate development, or government contracting (Datta, 2011).

Our anonymous expert adds (Domhoff, 2011b; Datta, 2011):

27.1 The Top 0.5%

- *Higher* one goes up the top 0.5% ladder, *more* likely it is that their wealth is in some way tied to the *investment* industry and *borrowed* money.
- In sharp *contrast*, *most* in the *bottom* 99.5% earn their income from *personally* selling *goods*, *services*, or *labor*.
- The *top 0.5%* are much more likely to have built their net worth from *stock options* and *capital gains* in stocks, real estate, and private business sales: *not* from income which is taxed at a much *higher* rate.
- The bulk of any CEO's wealth comes from stock, *not* income, and incomes are also very high.
- Those opportunities are largely unavailable to the bottom 99.5%

27.2 The Top .01%

- The top 0.1% can often borrow for almost *nothing*, keep profits and production *overseas*, hold personal assets in *tax havens*, *ride out* down markets and economies, and *influence* legislation in the U.S.
- Production, employment, profits, and taxes have all been *outsourced*.
- Around 40% of the *profits* in the S&P 500 come from *overseas* and *stay* overseas.
- About *half* of these 500 top corporations having their headquarters in *tax havens*.
- The wealthiest 400 American families paid an 8.2% average rate on their federal individual income taxes from 2010 to 2018, according to White House (Note 28).
- By comparison, Americans paid an average 13.3% tax rate on their income in 2018, according to a Tax Foundation report (Note 28).

The report's findings are similar to those of a recent ProPublica investigation, which found that some of the world's richest men (Jeff Bezos, Michael Bloomberg, Warren Buffett, Carl Icahn, Elon Musk and George Soros) pay a *tiny* fraction of their wealth in tax (Note 28).

The 25 richest Americans paid a true federal tax rate of 3.4% from 2014 to 2018, while seeing their net worth grow by $401 billion, according to the investigation, which cited confidential IRS data (Note 28).

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Section VIII. Forces that Led to the Stock Market Crash of 2008

28. Massive Deregulation Leads to the Worst 2008 Stock-Market Crash Since 1929

The enormous deregulation mentioned above, eventually led to a *meltdown* of the global financial markets in 2008, that many consider as the *worst* since the Great Depression (Datta, 2010b).

The TNT was the *collapse* of the U.S. *housing* market, and the *failure* of the $1.2 trillion *subprime* mortgage derivatives—Collateralized Debt Obligations (CDOs)—that major Wall Street banks had *created*, and *aggressively* sold around the world (*ibid*).

But the *rocket fuel* was the C*redit Default Swaps*—*CDS*—a market 50 times *bigger* than the subprime mortgage market (*ibid*).

29. Wall Street Pushes Risky Subprime Mortgage Securities

The *double-digit* rise in prices of existing homes *from 2000 through mid-2005* encouraged *speculation*. With Wall Street's *voracious* appetite for highly profitable *subprime* mortgages, many lenders virtually *ignored* their standards and began lending to *unqualified* buyers who were "one refrigerator away from default" (Datta, 2010b).

29.1 Belief that Diversification and Pooling Could Eliminate Default Risk

Relying on Li's Gaussian copula model, Wall Street banks began to believe that *default risk* in *subprime* mortgages could virtually be *eliminated* simply by a process of *diversification*: by *pooling* individual mortgages into *bundles* and slicing them into *tranches*, each with a *different* risk and return profile (*ibid*).

So, Wall Street introduced *new* CDOs—collateralized debt obligations—which were *backed* by "*low-rated* corporate bonds, emerging-market debt, and *subprime* mortgage loans." The argument was that in the event of a major flood, the *top* half of a ten-story building would be protected by the *bottom* five floors. The *highest* or the senior level was deemed the *safest* and the *lowest* level—called *equity* tranches—the *riskiest* (Datta, 2010b).

Wall Street and the *rating* agencies also *believed* that even the *lowest* quality bonds would *not* all default at the *same* time (ibid).

Amazingly, Wall Street successfully *convinced* the *rating* agencies that the *top* tranche—e.g., a pool of BBB-*rated* subprime mortgage loans—should be given AAA rating. These subprime senior securities offered significantly *higher* returns than ordinary AAA bonds (e.g., GE). Therefore, they generated a high demand among many *institutional* investors who generally bought only AAA-rated bonds. So, the largest investment houses and banks were able to *unload* billions of dollars of *subprime* equity tranches (*junk bonds*) onto state *pension funds* of public employees (Datta, 2010b).

29.2 Derivatives on Steroids: "CDO squared" and "CDO cubed"

When Wall Street banks could *not* sell some of the high-risk *bottom* equity tranches in different CDOs they then *combined* them into another pool called "CDO squared," and repeated the process with "CDO cubed."

A CDO-cubed is essentially a *triple* derivative, that is a derivative of a derivative of a derivative—which is why it has been called "*derivatives on steroids*" (Note 30). So, every time a *new* pool of the *riskiest* bottom tranches was created, it would yield a new crop of a *senior* tranche with AAA rating (Datta, 2010b).

30. Wall St. Resorts to Gambling by Pushing Virtual CDOs Not Backed by Real Securities

The passage of *Commodity Futures Modernization Act* (CFMA) of 2000 *rolled back* the *gambling* activity that was *illegal* for almost the entire twentieth century, as mentioned above. The act now *allowed* investors to *bet* on securities they did *not* own.

Partnoy (2009: 258), a former Stanley Morgan trader, and now a law professor at University of San Diego, believes this was "one of the greatest *mistakes* in the history of financial markets" (Datta, 2010b, *italics* added).

Soon Wall Street started running out of risky assets. The passage of CFMA allowed Wall Street to come up with an *ingenious*—and risky--idea: CDS (credit default swaps) based on *synthetic* or *virtual* CDOs (collaterized debt obligations) that *mirrored* a regular pool of *existing* mortgages. These synthetic CDOs allowed banks to sell *layers upon layers* of securities based on the *same* junk bonds (Datta, 2010b).

Wall Street banks *bought* huge amounts of the so-called *"super-senior" subprime* tranches of *synthetic* CDOs. According to the computer models, these AAA-rated securities were senior enough to be safe from even Noah's-era flood (Datta, 2010b).

30.1 Many Banks Put No Money Behind What They Insured

Believing in the above *delusion*, several companies—e.g., American International Group (AIG), Bear Stearns, and Lehman Brothers—that *insured* these bets with credit default swaps (CDS)--as mentioned in the next chapter--put *no* money behind their commitments (Datta, 2010b).

30.2 Most Banks Financed Subprime Mortgages via Short-term Borrowing

And, across the board, banks financed these *risky* assets through short-term financing (*ibid*).

Interestingly, J.P. Morgan was one company that opted *out* of the subprime mortgage business because it considered the business too *risky* (Tett, 2009: 103; Datta, 2010b).

When the housing market *collapsed*, the loss from the *subprime* mortgage-based CDOs *rose* from $300 billion to a *trillion* dollars (Datta, 2010b).

31. J.P. Morgan' Innovation: Credit Default Swaps (CDS)

In 1994 a team of brash, young, idealistic bankers from J.P. Morgan got together to address a problem that has bedeviled banks for ages: the risk of *loan default*. With "the heady arrogance of youth" they all believed "that they held the secret to transforming the financial world" (Tett, 2009: 4; Datta, 2010b).

The team introduced a *derivative* called credit default swap (CDS): an *insurance* policy that would enable a bank to *transfer* default risk onto a *third* party in lieu of payment of a regular *premium*. They argued that this would *revolutionize* banking because it would allow banks to *separate* risk from lending. This *seemingly* savvy maneuver would *free up* the bank's capital reserve, permit it to make *more* loans and *remove* the credit risk from its *books* (Tett, 2009: 44-45, 56; Datta, 2010b).

Later, recalling the event, Mark Brickell, J.P. Morgan's managing director, made the following memorable comment (Datta, 2010b):

- "I have known people who worked on the *Manhattan Project*. And for those of us on that trip, there was the same kind of feeling of being *present* at the creation of something *incredibly* important."

Ironically--like Oppenheimer and his team of *nuclear* physicists in the 1940s--little did Brickell and his group realize that they were creating a *monster*! (Datta, 2010b).

The Morgan team's *utopian* dream of separating risk from lending was *too good to be true* because it meant that: "you could *have* your cake and *eat* it too"! (Tett, 2009, inside cover, *italics* added; Datta, 2010b).

But *catastrophe* followed "when the J.P. Morgan team's derivatives dream collided with the *housing boom*, and was *perverted*…by *titans* of banking that included Citigroup, UBS, Deutsche Bank, and…Merrill Lynch…through *hubris*, *delusion*, and sheer *greed*" (*ibid*, inside cover, *italics* added; Datta, 2010).

In 1998 insurance giant AIG agreed to J.P. Morgan's overture to insure its super-senior *risk*; little did it know that this deal set it "on the path to near *ruin*" (Tett, 2009:62-63, italics added; Datta, 2010b).

AIG did *not* realize that credit default swaps were *far* more *complex* and *dangerous* than subprime mortgage derivatives, and because of their *size*, could potentially cause more *havoc* in a matter of *days* than the subprime mortgage derivatives caused in their first *year* (Datta, 2010b).

Warren Buffet presciently *predicted* that these derivatives were "financial *weapons of mass destruction*."

In September 2008 AIG was *unable* to cover its massive "credit default swaps" (CDS) losses. The U.S. government, considering it *too big to fail*, invested $180 billion in AIG (Datta, 2010b).

Earlier, in March 2008, The Federal Reserve Bank had agreed to *guarantee* $30 Billion in Bear Stearns' assets as a part of the Government-sponsored deal for JP Morgan to acquire Bear Stearns (Note 31).

In September 2008 Lehman Brothers filed for *bankruptcy* (Note 31).

Some securities packaged by Goldman Sachs and Tricadia were so vulnerable that they *failed* within *months* after they were created (Datta, 2010b).

Goldman Sachs, Deutsche Bank, and Tricadia used the CDOs—"collateral debt obligations"--to place unusually *large negative* bets that put them at *cross* purposes with their *own* clients (Datta, 2010b).

Commenting on this situation, Sylvan Raines, an expert in this field, said that when you buy *protection* against an event you have had a hand in *causing*, you are buying *fire insurance* on someone *else's*

house, and then committing *arson* (Datta, 2010b).

Michael Lewis, a former bond trader at Solomon Brothers, and the author of *Liar's Poker*, says it is *incredible* that a bank could *advise* customers on *what* to buy and sell, and at the same time *bet* against the securities they're trying to sell them (Datta, 2010b).

32. "Heads I Win Tails You Lose"

The U.S. government has a *long* history of *bailing out* the financial industry. This tradition *began* during the *panic* of 1792, when the government intervened to *prevent* the collapse of the securities market. Since then, the U.S. government has *bailed out* the industry *many* times over (Davis, 2021):

- The Great Depression
- The Savings and Loan Crisis
- The Conservatorship of Fannie Mae and Freddie Mac
- The Collapse of Bear Stearns
- The Rescue of American International Group (AIG)

To this we should *add* the passage of the *Emergency Economic Stabilization Act* passed in Oct. 2008, that created the $700-Billion *Troubled Asset Relief Program* (TARP) (Note 32).

The "go-for-broke" incentive schemes shower *rich* rewards for *making* money, but impose *little* penalty for *losses*.

James Grant (2010), editor of *Grant's Interest Rate Observer*, says the basic *flaw* of the U.S. banking system is *socializing* risk and *privatizing* gain. He adds that the U.S. government needs to "bring the *fear* of *God* back to Wall Street"—as it was at the turn of the 20th century (*italics* added). He suggests that the U.S. should follow the example of Brazil, and hold bank directors and senior managers *personally* liable for the solvency of their bank. And if the bank fails then the value of their personal assets—houses, cars, yachts, etc.—should be assigned to the bank's creditors (Datta, 2010b).

In an *intriguing* article in *Atlantic*, William Cohan (2012) says that imposing *hard* limits on risk-taking may *stifle* innovation. He argues that the problem in Wall Street has *not* been about the absolute amount of leverage. Rather, it is about whether the financiers have the *proper* incentives to manage the *risks* they are undertaking. He suggests that, like James Grant, it is important to *ensure* that executives in the financial industry have a *skin in the game*.

Before 1970 Wall Street investment banks were *private* partnerships. However, a *transformation* began in 1970 when Donaldson, Lufkin & Jenrette became a *publicly*-held company. This process continued until 1999 when Goldman Sachs went *public* (Carney, 2010).

Cohan (2012) points out that during Wall Street's heyday during the partnership era, "*shared* risk ensured a modicum of *prudence* even though leverage was often *higher* than 30-to-1."

However, when partnerships became *public* corporations, "the partnership culture gave way to a *bonus* culture in which employees felt *free* to take *huge* risks with *other* people's money to generate revenue and *big* bonuses" (Cohan, 2012, *italics* added).

33. The Bank Bailout Act of 2008

The Emergency Economic Stabilization Act of 2008, passed in Oct. 2008, created the $700 billion *Troubled Asset Relief Program* (TARP) to purchase *toxic* assets from banks. The funds were mostly *redirected* to *inject* capital into banks and other financial institutions while the Treasury continued to examine the usefulness of targeted asset purchases (Note 32).

34. Major Factors Behind the Massive Failure of Credit Default Swaps--CDS

Several factors contributed to the *failure* of CDS which were the *overwhelming* factor that brought about the 2008 financial crisis (Datta, 2010b):

- The CDS derivatives were so *complex* that hardly *anyone* understood them: *not* even Soros.
- Rohatyn described them as potential "hydrogen bombs."
- Warren Buffet presciently *predicted* that these derivatives were financial weapons of *mass destruction.*
- The bond *rating* agencies were "handmaidens" of major Wall Street banks who *paid* them for rating the bonds; and higher the rating, higher the payment.
- *Lacking* expertise, the rating agencies *allowed* Wall Street banks to *design* the *computer* models they used to rate bonds. So, when Goldman Sachs repackaged the *worst* subprime mortgage loans--they earlier couldn't sell--they were still able to get AAA rating from Moody's.
- They were *private*—opaque—contracts between two parties that were totally *unregulated*, and whose market value could *not* be determined.
- The participants in this market were *tied* to each other largely *within* the financial world's version of a black box. This led to a *concentration* of a large amount of risk among a *few* companies, so that the troubles of *one* could quickly *infect* others.
- But several companies—e.g., American International Group (AIG), Bear Stearns, and Lehman Brothers—that *insured* these bets put *no* money behind their commitments.
- In 2007 Bear Stearns had a debt-equity ratio of 35.6 to 1 (Note 33). As mentioned in Chapter 31, the Federal Reserve Bank agreed to *guarantee* $30 Billion in Bear Stearns' assets as a part of the Government-sponsored deal for JP Morgan to acquire Bear Stearns.
- In 2008, Lehman Brothers had $639 billion in assets, technically more than enough to cover its $613 billion in debt. However, the assets were *difficult* to sell. As such, Lehman Brothers *couldn't* sell them to raise sufficient funds. As a result, Lehman Brothers was forced to file for *bankruptcy*, as mentioned in Chapter 31 (Note 34)
- Across the board, banks financed these *risky* assets through *short-term* borrowing.
- A *fatal* flaw in CDS is their *inability* to handle *systematic* risk. It is a risk that is based on the possibility that derivative contracts of a company are *not* independent, and *all* may be dragged into a recession *simultaneously*.

- Although the *financial* sector has enhanced its ability to *spread* risk more widely, it also *exposes* the system to *large systemic* shocks, and has therefore made the world *riskier*.
- While an individual business may be able to transfer default risk to another, the *entire* financial system *cannot* successfully pass the risks off through ever more ‘sophisticated’ financial modeling.
- A major factor behind the stock market crash is that there is a sense of *entitlement* among Wall Street bankers. They expect *huge* bonuses—because they believe “they have earned it”—that are *out of all* proportion to their contribution to the American economy.
- A bond derivative trader can make more money in *one* good *year* than a doctor or airline pilot will make in an entire *career*.
- This encourages everyone to take *excessive* risks with “Other People’s Money.”
- The performance of CEOs is partly determined by the income they generate compared to their *peers*. So, when a competitor reports an *impressive* income record, it puts a lot of *pressure* on CEOs of *other* banks to keep up with the leader, and this may induce them to take *excessive* risks to boost their performance.
- Huge compensation of CEOs in the financial industry led many of them to focus on *short-run* profits. *Before* the 2008 crash, executives at large American banks repeatedly cashed-in *large* amounts of pay based on *short-term* profits: even at the cost of an excessive increase in *risk* of large *losses* in the future.
- In 2009--right *after* the financial meltdown of 2008--the leading Wall Street firms paid $140 billion in compensation and benefits to their traders: the *largest* collective payday on record at that time!
- Nobel Laureate Tobin points out that such *extraordinarily* high rewards are “*disproportionate* to social productivity” (Andersen, 2020, p. 182; *italics* added).
- The business of Wall Street has become *divorced* from productive enterprise, and that Wall Street leaders have completely *lost* any sense of *social* responsibility.
- Greenspan, Chairman of the Federal Reserve Bank, championed the *laissez faire free*-market ideology. Soros calls it *market fundamentalism.* This ideology also played a *key* role in this financial collapse. Greenspan strongly *resisted* calls for regulating derivatives. He said that Wall Street had *tamed* risk, and seemed to consider derivatives as almost *infallible*. He believed that since *large* institutions have been able to grow, it meant that many of the larger risks were *fully* hedged.
- Novelist Ayn Rand, who projected *collective* power as an *evil* force *against* the self-interest of individuals, seems to have exerted a *powerful* influence on Greenspan’s worldview.
- *Futures Modernization Act* of 2000, *allowed* investors to bet on securities they did *not* own, and *rolled back* the *gambling* activity that was *illegal* for almost the entire twentieth century.

- The *Financial Services Modernization Act* of 1999 *repealed* the *Glass-Steagall Act* of 1933 which was designed to *separate* commercial banking from investment banking to *protect* bank *depositors* from the dangers of bankers indulging in *risky* investments and *speculation*.
- The "go-for-broke" incentive schemes showered *rich* rewards for *making* money, but imposed *little* penalty for *losses.*

35. Conclusion

In 1914 Henry Ford offered his workers a wage that was more than *double* the average prevailing factory wage. Ford may have made this decision on the belief that his workers could then *afford* to buy the cars they made.

And that is how the American *middle class* was *born*.

The Great Depression of 1929--a result of reckless *speculation*--was the *worst* economic downturn in the history of the industrialized world, lasting from 1929 to 1939.

Unemployment in cities like Toledo, Ohio climbed up to 80%, and in Lowell, MA as high as 90%.

President Herbert Hoover, a Republication, employing a *hands-off* approach, said that it was *not* the business of the government to directly intervene in the economy, and that it was *not* the responsibility of the government to create jobs, or provide economic relief for the public.

President Franklin D. Roosevelt (FDR), a Democrat, reassured the American public that the only thing they had to fear is *fear* itself.

He instituted the *New Deal* which was a series of programs and projects meant to address the serious problem of *high* unemployment.

The major contributions of the New Deal were:

- The *Social Security Act* of 1935 which guaranteed *pensions* to millions of Americans.
- The *National Labor Relations Act* to monitor union elections and *prevent* management from treating their workers unfairly.
- The *Glass Steagall Act* which was designed to *separate* commercial banking from investment banking.
- A system of *unemployment insurance*.
- The G.I. Bill aimed at the returning WWII soldiers (veterans). The GI Bill *opened* the door of higher education to the American working class as *never* before. The U.S. government also *guaranteed* loans for veterans that enabled them to buy a home, business, or farm.

The years 1947-1973 are considered the golden years of America's middle class: an age the U.S. will never experience again. The foundation of this *goldilocks* economy was the social *covenant* of *shared* prosperity between big business and big labor.

The 1980-2008 period marks America in *decline.* This is largely because America took a *sharp* turn toward *unfettered* capitalism and greed, with a focus on *maximizing* shareholder value.

This new mind-set encouraged *risk aversion* and *short-run* behavior: an accountant's *short cut* to profits,

with a focus on *cost reduction*, rather than *long-term* concerns about innovation, quality, and customer satisfaction.

Another important factor that contributed to the decline of the American economy was *outsourcing*: which meant *ceding* the Industrial Commons to the *competition*.

Income inequality has seen a steady *increase* in America for 45 years from 1974-2018, and by 2007 it *touched* or *exceeded* the lofty heights of 1928.

A socio-economic class lifestyle profile of America includes *three* groups: *The Upper Class*, *The Middle Class*, and *The Lower Class*, each with two classes, making it a total of *six*.

Finally, we list the *factors* that brought about the *worst* stock-market crash of 2008 since 1929.

First, John Bogle says the U.S. financial sector is *enormously* profitable. He suggests that we have become a *financial* economy which has *overwhelmed* the productive economy to the detriment of investors, and the detriment of our society.

Leading International Monetary Fund (IMF) economists warn that the American financial sector has become so *large* that it is *slowing* economic growth.

Second, Nobel Laureate James Tobin expressed *dismay* at the *casino* aspects of our financial markets. He points out that we are throwing *more* and more of our resources--including the cream of our *youth*--into *financial* activities away from the *production* of goods and services.

He believes that the immense power of the *computer* is being harnessed to serve the *paper* economy that encourages *speculation.*

Very *little* of the work done by the securities industry has to do with the financing of *real* investment.

Third, A major factor behind the stock market crash is that there is a sense of *entitlement* among Wall Street bankers. They expect *huge* bonuses—because they believe “they have earned it”—that are *out of all* proportion to their contribution to the American economy.

Nobel Laureate Tobin points out that such *extraordinarily* high rewards are *disproportionate* to social productivity.

Fourth, the *double-digit* rise in prices of existing homes from 2000 through mid-2005 *encouraged* speculation. With Wall Street’s *voracious* appetite for highly profitable *subprime* mortgages, many lenders virtually *ignored* their standards and began lending to *unqualified* buyers.

Wall Street banks began to believe that *default risk* in *subprime* mortgages could virtually be *eliminated* simply by a process of *diversification*: by *pooling* individual mortgages into *bundles* and slicing them into *tranches*, each with a *different* risk and return profile.

Amazingly, Wall Street successfully *convinced* the rating agencies that the *top* tranche—e.g., a pool of BBB-rated *subprime* mortgage loans—should be given AAA rating.

Fifth, the passage of *Commodity Futures Modernization Act* (CFMA) of 2000 *rolled back* the *gambling* activity that was *illegal* for almost the entire twentieth century. Partnoy, a former Stanley Morgan trader, believes this was one of the greatest *mistakes* in the history of financial markets.

Sixth, the *Financial Services Modernization Act repealed* the *Glass-Steagall Act* of 1933 which was

designed to *separate* commercial banking from investment banking.

Sixth, J.P. Morgan introduced a *derivative* called Credit Default Swap (CDS): an *insurance* policy that would enable a bank to *transfer* default risk onto a *third* party in lieu of payment of a regular *premium*. They argued that this would *revolutionize* banking because it would allow banks to *separate* risk from lending. This *seemingly* savvy maneuver would *free up* the bank's capital reserve, permit it to make *more* loans, and *remove* the credit risk from its *books*.

The Morgan team's *utopian* dream of separating risk from lending was *too good to be true* because it meant that: "you could *have* your cake and *eat* it too"!

The CDS were *far* more *complex* and *dangerous* than subprime mortgage derivatives, and because of their *size* could potentially cause more *havoc* in a matter of *days* than the subprime mortgage derivatives caused in their first *year.*

Warren Buffet wisely predicted that the credit default swaps—CDS--were "financial *weapons of mass destruction."*

When the stock market crashed, the *TNT* was the *collapse* of the U.S. *housing* market, and the *failure* of the $1.2 trillion *subprime* mortgage derivatives.

But the *rocket fuel* was *CDS*—a market 50 times *bigger* than the subprime mortgage market.

Seventh, several companies—e.g., American International Group (AIG), Bear Stearns, and Lehman Brothers—that *insured* these bets put *no* money behind their commitments.

Most banks financed *subprime* mortgages via *short-term* borrowing.

Finally, the dramatic *collapse* of the financial services industry in 2008, is a resounding *affirmation* of the idea, as mentioned earlier, that the *Friedman* doctrine of *maximizing shareholder value* is *neither* good for society *nor* even for the shareholders—Jack Welch's General Electric being a *prime* example.

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Notes

Note 1. https://www.history.com/topics/great-depression/great-depression-history

Note 2. Great Depression | Definition, History, Dates, Causes, Effects, & Facts | Britannica

Note 3. https://www.imf.org/external/pubs/ft/fandd/2014/09/basics.htm#:~:text=British%20economist%20John%20Maynard%20Keynes,wage%20demands%20(see%20box).

Note 4. https://www.history.com/topics/great-depression/new-deal

Note 5. (1) was new deal created based on keynsian theory - Search (bing.com)

Note 6. G.I. Bill - Definition, Forever GI Bill & Benefits - HISTORY

Note 7. Levittown - Wikipedia

Note 8. The 1950s - American Culture & Society - HISTORY

Note 9. The Interstate Highway System - Definition, Purpose & Facts - HISTORY

Note 10. Reuther's Treaty of Detroit - Wikipedia

Note 11. These were state and local laws that existed for about 100 years, from the post-Civil War era until 1968—were meant to marginalize African Americans by denying them the right to vote, hold jobs, get an education or other opportunities. Jim Crow Laws: Definition, Facts & Timeline - HISTORY

Note 12. The 1960s History - HISTORY

Note 13. Fair Housing Act - HISTORY

Note 14. Organization of Petroleum Countries

Note 15. OPEC enacts oil embargo - HISTORY

Note 16. This Chapter has been taken from Datta (2021).

Note 17. US. CHIPS Act: What Is It, What It Means For You | Tech360.tv

Note 18. President Biden Signs the CHIPS and Science Act - Alliance for American Manufacturing

Note 19. Union Members Summary (bls.gov)

Note 20. CEO Pay Soars to 361 Times that of the Average Worker | AFL-CIO

Note 21.
https://www.reuters.com/article/us-people-jackwelch/neutron-jack-welch-who-led-ges-rapid-expansion-dies-at-84-idUSKBN20P20T

Note 22. https://companiesmarketcap.com/general-electric/marketcap/

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Note 24.
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Note 25. Bureau of Economic Analysis 1967-2017: Table B-6.

Note 26. This is the term that Prahalad and Hart (2002) have used in their paper (Datta, 2011).

Note 27. https://aspe.hhs.gov/2018-poverty-guidelines

Note 28.
https://www.cnbc.com/2021/09/23/americas-richest-400-families-pay-a-lower-tax-rate-than-average-taxpayer.html

Note 29.
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Note 31.
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Note 33.

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