CHAPTER 19

MAGIC OF THE MARKET

The United States was suffering from an "economic affliction of great proportions," remarked Ronald Reagan in his 1981 inaugural address. In a rejection of FDR's 1933 first inaugural, the new president declared that "in this present crisis, government is not the solution to our problem, government is the problem."[1] The solution was the market or, more specifically, what Reagan would soon call "the magic of the marketplace."[2]

Market advocacy was not new. In the American past, markets had been celebrated in at least three ways: as arenas for a positive vision of individualism, as engines of economic betterment, and as just arbiters of social and political conflict. In the 1970s crisis of industrial capital, market advocacy had appeared in all these forms. However, the 1980s saw an absolute "contagion" of market metaphors.[3]

Pro-market, "neoliberal" ideology, as some scholars call it, mattered, but it cannot explain everything. Just because a market advocate such as Friedrich Hayek or Milton Friedman once said something about the market does not mean that when Reagan became president, something in particular came to pass. In reactive mode after Reagan's election, much of the intellectual left fell prey to assuming it did, hauling out a neo-Victorian, romantic critique of the corrosively greedy "market."[4] But to debate the appropriate moral limits of the market—a salutary debate, to be sure—is not to say all that much about how and why capitalist enterprise since Reagan has changed.

In this period, much of the devil was in the details of economic life—not in grand ideological pronouncements about the market, which Reagan, as well as his advocates and his critics, had a great proclivity to espouse. After all, Reagan's invocation of the "magic" of the marketplace expressed the former Hollywood actor's belief that "politics is just like show business."[5] In a 1980 campaign commercial, an unemployed white, blue-collar-looking man had stood in the middle of an idling factory just waiting for the magic of the market to put it right after Reagan's election. How nice if a magic wand could instantly solve the "crisis of confidence" that President Carter had declared in 1979. Reagan's election did help augur in a new age of capitalism, but the transformation cannot be easily attributed to the conscious intentions of his administration, as it rolled into office.

On the campaign trail, Reagan and his advisers predicted that letting the market decide (whatever that meant) would lead to a surge in private savings, fixed investment, productivity growth, and profits. Altogether the combined result would be a national revival in manufacturing employment and output, and also in manufacturing exports, which would reverse the U.S. trade deficit. Reduced federal spending, especially on welfare, would lead to a balanced federal budget and a lower national debt.

The day after Reagan's inauguration, stock prices at the New York Stock Exchange (NYSE) began to climb. Against surprisingly little resistance from Democrats, Reagan was able to push through much if not all of his agenda. Basically, what happened next was that none of what Reagan had promised came to pass. Reagan delivered on but one economic campaign promise, a military buildup, in line with his early confrontational stance toward the Soviet Union. Based on high-tech weapons, it was a version of the old military Keynesianism but far less employment intensive.[6] It was also financed by budget deficits. Dogged to the end, Reagan never stopped putting faith in what his favorite supply-side economics intellectual, George Gilder, called the "metaphysical capital of human freedom and creativity."[7] But of Reagan, the Federal Reserve chairman Paul Volcker judged, "I speculate that he was not a highly sophisticated economist." Of the president's economic advisers, Volcker concluded, "They had monetarist doctrine, supply-side doctrine, libertarian doctrine all mixed together." It "wasn't terribly coherent."[8]

All the same, by the end of Reagan's first term, a new age of capitalism had already been born. Reaganite supply-siders argued that liberal, demand-focused Keynesians had put the cart before the horse. In capitalism, the supply-side decisions of entrepreneurial capitalists were where all the magic happened. There is some truth to that (as Keynes himself had long ago recognized). But the Reaganites bet on a supply-side horse that turned around and ran the wrong way, or at least in an unexpected direction. As capital was liberated on the supply side, the pattern of capital investment was transformed. There was no going back to postwar industrial society. During the Reagan years, not only did a "postindustrial" economy continue to materialize, but something new and distinctive emerged that has persisted down to this day: a capitalism dominated by asset price appreciation.

The new capitalism would feature some durable new patterns: a surge in service employment, a shift in the share of income from labor to capital and therefore an increase in inequality, a spread of the Houston model of Sunbelt development, a reconfiguration of global U.S. economic hegemony, a commitment to low inflation and price stability, an expansion of debt and leveraged profit making, and more. All, as well as their interrelationships, require elucidation. But all of it revolved around one key new characteristic of the rising economic order, which was a high degree of liquidity preference among the owners of capital. It injected a new quality of uncertainty into economic life, as the short term triumphed over the long.

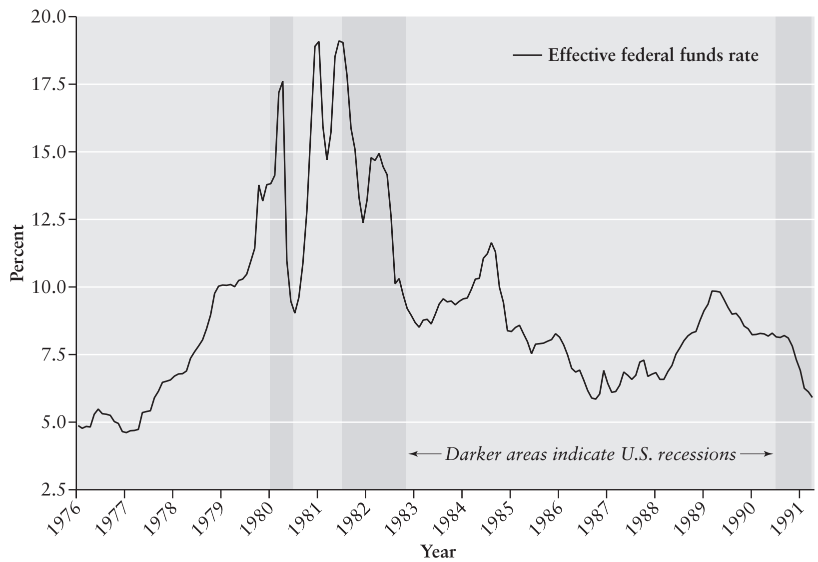
But the first question is how exactly the new age of capitalism first came about. When Reagan took office, the inaugurating event had already begun, down the street from the White House at the Federal Reserve.

1. Volcker Shock

President Carter had appointed Paul Volcker chairman of the Fed in 1979. Thus Reagan became president in the middle of the Volcker interest rate "shock." Not since after World War I, when, in the context of postwar inflation, the victorious Allies made the decision to return their currencies to the gold standard, had state power so overtly enforced the scarcity value of money capital in an attempt to attack inflation.

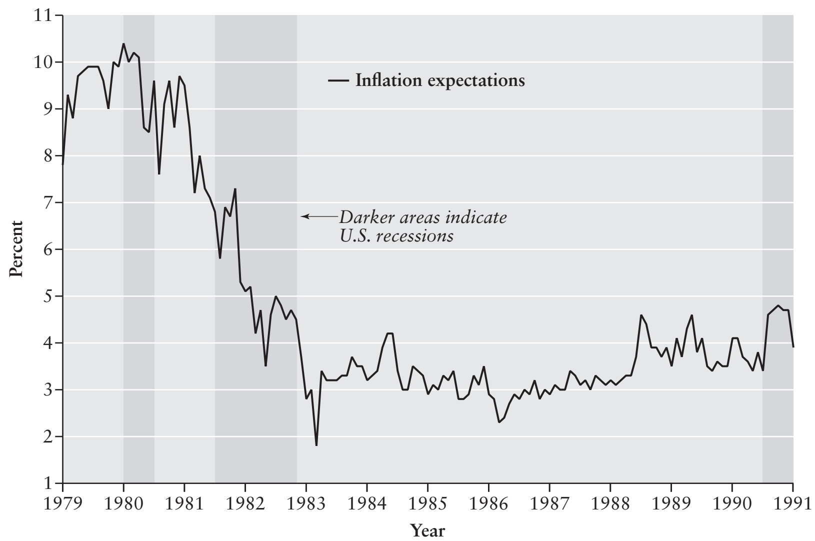
The difference was that now currencies were no longer backed by metal. The discretionary authority of the Fed controlled the money supply of the dollar—still the global currency of transaction and reserve. The Volcker Shock successfully slew the inflationary dragon, in a broad reboot for the U.S. and global economy.

Inflation, said Volcker, "was a dragon that was eating at our innards, or more than our innards."[9] The Fed's experiment with monetarism was an example of letting the market decide. Since the postwar period, the Fed had sought to adjust the quantity of money on the supply side, indirectly, by using its powers to set a target short-term interest rate in the credit market, or the market for short-term U.S. Treasury bills, the nearest equivalent to cash. Monetarism said that the Fed must intervene more directly, targeting the actual quantity of money. Less money would mean less inflation. Interest rates on credit would then set themselves in the market, free from government intervention. However, as the quantity of money was restricted, the cost of credit—interest rates—would increase accordingly. Short-term interest rates surpassed 19 percent in 1981.



EFFECTIVE FEDERAL FUNDS RATE
The Volcker Shock brought about both high and (less expectedly) volatile interest rates. Historically, rates remained elevated over the 1980s.

With money and credit so tight, spending decreased, and the U.S. macroeconomy plunged into the double-dip recession of 1980 and 1981–82, the worst since the Great Depression. The initial downturn contributed to Reagan's election. Once in office, Reagan largely left Volcker to his job. "I think he had some kind of a feeling that the Federal Reserve was trying to deal with inflation," Volcker remembered.[10] Unemployment reached 10.8 percent. The Fed ended the monetarist experiment in October 1982. A macroeconomic recovery ensued in the midst of newfound price stability. The shock worked. The dragon of inflation was slain.



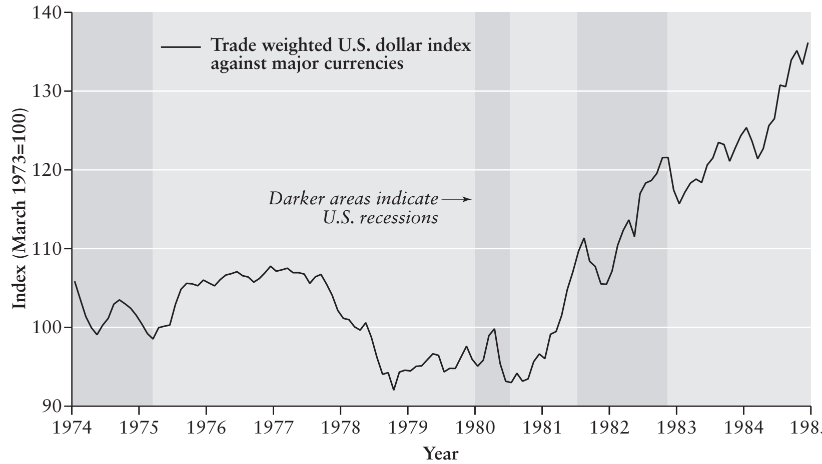
INFLATION EXPECTATIONS
The Volcker Shock dramatically quelled both inflation and expectations of future inflation.

The Volcker Shock was a reboot for both politics and economics. In politics, it brought about a policy regime change not seen since the days of FDR (when FDR had relaxed the scarcity value of money). Surely no government since the Great Depression had believed that government-induced double-digit unemployment, on behalf of deflation, was a legitimate policy option. Volcker was not a very popular public figure during the 1980–82 recession, and he was hauled before Congress for the occasional tongue-lashing. Nonetheless, he judged correctly that he had room to maneuver. Both Congress and the public sensed that "something had to be done," he surmised.[11] Volcker was not a complete believer in Milton Friedman's monetarism, which argued that economic growth always followed, after a lag, from an increase of the money supply, and that inflation was always and everywhere a result of the money supply increasing too much. The Fed, Friedman thus argued, should always target a steady increase in the money supply that approximated the capacity of the "real" economy to grow—"real" meaning independent of money. Strangely enough, monetarists thought the underlying "real" economy had nothing much to do with money. Volcker surmised that the monetarist targeting of the quantity of money would provide good political cover for the job that needed to be done. By targeting the money supply, the Fed was not responsible for setting punishingly high interest rates. The market was deciding.

In fact, the Federal Open Market Committee (FOMC) retained broad discretionary power. Further, the actual quantity of money and credit, a matter of both supply and demand, is not so easy to know or even to define, and may respond to upsurges in economic activity as much as it may initiate them. Monetarism in use was emblematic of what market deregulation in this period actually looked like. After Reagan's election, policy makers in general increasingly expressed a preference for market prices over government regulations. But regulation is not always a zero-sum game—with there being either more of it or less of it.[12] In this period, power in economic policy making was shifting from the Congress and the presidency to administrative agencies that, by their very design, were less democratically accountable.[13] Above all, the Fed ascended to regulatory preeminence.

The mantra in monetary policy soon became "central bank independence."[14] Even if Volcker's Fed would scrap monetarism, Friedman's basic argument prevailed. This meant the Fed had to follow a simple and transparent "rule." It should target a noninflationary and thus "neutral" interest rate, neutral in that it kept the growth of the money supply in line with the growth of the real economy. The Fed had only to set the right interest rate and it could sit back and watch the market economy optimize itself. Inflation could take priority over unemployment, since with low inflation and a stable general price level, employment would find equilibrium at its "natural" market level. As democratic politics were not likely to facilitate a neutral interest rate, which the inflationary 1970s so well illustrated, the central bank had to be independent from elected politicians.

The triumph of "independent" monetary policy was one long-lasting result of the Volcker Shock. Another was an utter transformation of American hegemony in the global economy. Inflation had threatened the primacy of the dollar as the global currency of transaction and reserve. This had spooked Carter and also had frightened Volcker. "I was certainly worried about the future of the United States in terms of its place in the world," Volcker later said. "I grew up in a generation where you naturally look upon the United States as being the last great hope of mankind."[15] The high interest rate of the Volcker Shock recruited short-term, speculative hot money into the United States, in search of the generous rate of return on offer. The consequence was to bid up the dollar,



TRADE WEIGHTED U.S. DOLLAR INDEX AGAINST MAJOR CURRENCIES
The high interest rates of the Volcker Shock contributed to a rapid increase in the value of the dollar, securing its continued hegemony as the global currency of transaction and reserve.

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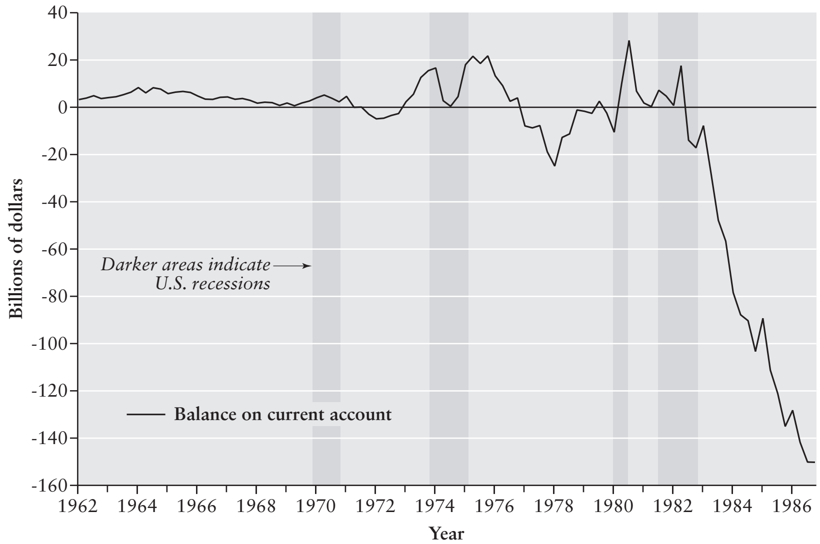
Meanwhile the high dollar led to a surge in U.S. imports, while undermining the competitiveness abroad of American manufacturing exporters. The opposite side of the same coin was that capital inflows financed the bulging U.S. trade deficit. In a new global trend, capital ran "uphill" into American capital markets.[16]

In short, the Volcker Shock launched a second, far more novel U.S. global hegemony. After World War II, the United States, like many world hegemons before, was an exporter of both capital and goods to the world.[17] After the Volcker Shock, these movements reversed. Now the United States imported global capital and became the consumer market of last resort for the world's producers.[18] Likely the Fed neither intended nor expected to trigger such a momentous shift. True, relative to many other national economies, the United States remained rather "closed," with world trade comprising a very small percentage of GDP. But that small percentage could matter very much—in the way new trade patterns affected some localities, as well as in the increasing prominence of global finance—and the new global configuration would, at specific moments, have great consequence in this new age.

Meanwhile the consequences of the Volcker Shock were no less signifi-



BALANCE ON U.S. CURRENT ACCOUNT
As the owners of wealth sought security in safe-haven dollar assets, the export of capital to the United States financed the critical role of the American consumer in the global economy—as foreign capital inflows closed the U.S. current account deficit, or its balance of transactions with the world, excluding financial items. In the Age of Chaos, global capital movements would ultimately supersede trade patterns in macroeconomic importance.

cant, or surprising at the time, for the U.S. national macroeconomy. By tightening the money supply, the Volcker Shock brazenly restored the scarcity value of money capital. Just as with foreign hot money, high and volatile interest rates recruited capital into the money form, in search of income from interest rate accrual, in the midst of a sudden corporate purge of not-very-profitable industrial fixed capital. Deindustrialization surged in the northeastern-midwestern manufacturing belt.[19] The new emphasis was on short-term, financial profit making. The Volcker Shock thus induced a greater liquidity preference. This was all the opposite of Reagan's promised manufacturing revival.

In some sense, the fixed capital purge had been a long time coming. The U.S. profit rate, especially for industrial corporations, had been in decline ever since 1965.[20] Capital moved toward the low-wage Sunbelt South, as well as abroad through corporate multinational investment. Despite the 1977 wave of steel plant closures in Ohio and Pennsylvania, many industrial corporate managers, as if by habit, had tried to invest their way out of the profitability crisis. No more. Between 1979 and 1983, the percentage drop in fixed investment in manufacturing structures and equipment was the steepest on record. Employment in durable goods manufacturing fell by 15.9 percent, with the loss of more than 2 million jobs—overwhelmingly male jobs.[21] Prime-age (25–54) male employment fell from 91 percent to 86 percent.

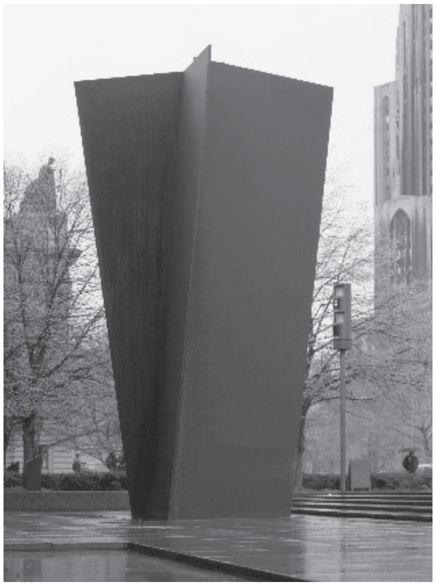
The origins of this transformation preceded the Volcker Shock. Among industrial corporations, a new conception of capital investment had been developing for some time. Business consultancies and finance-trained corporate managers drew from financial economics, whether it was "portfolio theory" or the "capital asset pricing model."[22] Postwar managers had been committed to growth in production and market share as well as a long-term rate of return on investment (ROI) on fixed capital. As profits flagged, time finally ran out on the industrial managerial class. The new goal was to maximize an immediate, risk-weighted "return on equity," or paid-in capital. Thomas E. Copeland and J. Fred Weston's *Financial Theory and Corporate Policy* (1979), for instance, distilled the new thinking.[23] The basic point was clear, however: pull capital from less profitable lines of production and deploy them wherever more immediate profits can be made.

That sounds obvious—maximize profits. But the profit motive, over the short or long term, had not been the only postwar managerial consideration, and managers, many of whom lived near production facilities, including factories, were often committed to specific localities. Some were committed to particular production processes. They therefore did not see their investments as always convertible and liquid, or the entire globe, and all economic sectors, as open fields of potential investment. But financial economics had no concern for physical process or human frictions. It assumed transactional liquidity, or the potential convertibility of all investments, with no physical sources of friction. No less, it assumed capital would always seek the highest profit. It assumed an economic rationality in which the owners of capital would not hoard money but would always invest in the most profitable asset class, adjusting for risk.

Here the Volcker Shock came into play, as it led to a dramatic pause in long-term fixed capital investment among corporate managers. High interest rates made credit for investment of any kind scarce, while recession only undermined profits for reinvestment. Furthermore, as the Fed relinquished control over interest rates during the monetarist experiment, rates not only climbed but became far more volatile than usual. The turn to the market made things more unpredictable and uncertain. In response, the owners of capital hoarded what cash they had, sapping long-term investment. Why not simply park corporate cash in a bank account, and earn profits through interest rate accrual, as the Fed enforced the scarcity value of capital? Between 1979 and 1982, the percentage of manufacturing firms' total revenues resulting from "portfolio income," whether dividends, capital gains, or interest accrual, climbed from 20 percent to 40 percent. As a share of portfolio income, interest accrual, which stood at 40 percent in 1965, climbed to over 70 percent.[24] In the shift from profit making on productive capital to more liquid, money-like assets, this was the first Volcker Shock–induced step. The pursuit of rentier profits on money capital was a trigger for the recession. Every dollar that sat in a bank account, seeking high interest rates, did not fund employment-giving or output-expanding investments.

Meanwhile deindustrialization in the northeastern-midwestern manufacturing belt accelerated, with the Midwest suffering the most. Many working people experienced the new "profit orientation" as something like a shock. In 1980 a round of steel closures hit the Calumet region, south of Chicago and in northwestern Indiana, eliminating ninety thousand manufacturing jobs. Local communities met the closures with "bewilderment" and "disbelief" because many of the factories were profitable. But they were not profitable enough by the new criteria, applied by executives at an ever-increasing distance from the "physical process."[25] The new CEO of U.S. Steel, David Roderick, declared that the corporation was "no longer in the business of making steel." It was "in the business of making profits." U.S. Steel announced major layoffs in Pittsburgh, shut down the old Carnegie Homestead works, and built a new, highly automated facility in Houston. By 1984, having bought Marathon Oil, U.S. Steel counted steel as only one-third of its assets.[26] Emblematically, Richard Serra's Pittsburgh sculpture *Carnegie* (1985), a monument to the U.S. industrial past, was of course made of steel.

In 1982, capping the Volcker Shock deindustrialization cycle, Bethlehem Steel closed its sprawling Lackawanna, New York, steelworks outside Buffalo. As steelworker Benjamin Boofer recalled, "Things got to booming pretty good, then all three plants'd be going like crazy, then things fell apart completely one day." Kenneth Sion added, "Everything was booming, and all of a sudden it stopped, just like that."[27] That was not true—



Richard Serra, *Carnegie* (1985)
Many industrial structures, including steel factories, were swept away by the 1980s' turn to finance and the triumph of the ideology of "shareholder value" in corporate governance. In this monument to Pittsburgh's industrial past, it is as if the effect was to turn the industrial upside down. Visually the top appears to be heavier than the bottom. Recall that Carnegie himself had once turned from finance to industry; in the 1980s the direction reversed.

things had not been booming. But the sense of a sudden "shock" in economic life was real enough. One day the factory closed, and, as their union had no say in corporate investment and disinvestment decisions (a limit to adversarial postwar collective bargaining over pay), neither Boofer nor Sion could do anything about it.[28] Workers had a "concern for physical process." The metaphor of body and plant appeared time and again. Lackawanna steelworker Dick Hughes said, "You feel it's a part of your life, it's a part of your body. . . . It's like getting a part of your stomach cut off, if the plant closes."[29]

More shock was to come for organized labor in manufacturing. In 1980, 42 percent of union households voted for Reagan. In 1981–82, the AFL-CIO, still the largest labor organization in the world, lost a staggering 739,000 members.[30] In August 1981 the Professional Aircraft Traffic Controllers Organization (PATCO) voted to go on strike over pay. Reagan granted PATCO a forty-eight-hour deadline for its members to return to work, and when they did not, the president replaced them. That step was technically legal, but few employers had been willing to take it since the New Deal.[31] Emboldened now, private employers followed. The number of strikes plummeted.[32] In the United States, male-employment-intensive industry was fast becoming a dead end for organized labor.[33]

The Fed finally ended the monetarist experiment in October 1982. But first, it began to perform a new function in capital markets. Not only did it help to usher in a greater liquidity preference through high and volatile interest rates, it also took new steps to ensure that transactional liquidity always existed for the owners of appreciating assets.

The convertibility of assets, including debts, was becoming the new functioning norm. In 1984 Continental Illinois National Bank, the sixth largest bank by assets in the United States, was on the brink of failure.[34] Taking advantage of new sources of funding in the money markets, the bank had increased leverage and made a number of risky loans to domestic oil producers. They went bad after the Volcker Shock depressed commodity prices. High interest rates made it more difficult for Continental to roll over its debts. A Japanese investor sell-off, in the wake of an unfounded rumor, led to a run on Continental's stock. But a Continental failure threatened contagion, as due to financial deregulations, capital and credit markets were becoming more fluid and transactionally interlinked. A single bank failure thus threatened a broader panic. In 1983 John Shad, the Reagan-appointed chairman of the SEC, informed Congress about the "unprecedented movement of capital" across financial institutions. Money and credit were jumping across "traditional gaps," overwhelming "regulation by industry categories." According to Shad, capital was "thundering over, under, and around Glass-Steagall," the New Deal wall separating commercial from investment banking—such as in new "over-the-counter" markets, for instruments such as interest rate "swaps."[35] Because of the Volcker Shock, bankers had new access to money and credit, even if at higher rates. But if confidence departed, capital could just as easily engage in flight, crippling financial institutions, solvent and insolvent alike.

The Fed decided to try to bail out Continental. It granted the bank credit through its "discount window," accepting collateral that no private actor would accept. The Fed thus granted funding, and transactional liquidity, so that Continental might remain solvent—if only for a time. In 1984 the bank went into FDIC receivership. At that time Continental was judged "too big to fail," but it was much too interconnected to fail. Acting as lender of last resort, the Fed had come to the rescue of the system. To observers, it was seen as an extraordinary intervention, a departure from the past, which it was.

Meanwhile the Fed's new responsibilities became global. On June 30, 1982, the FOMC met to discuss the "saga of Mexico." During the inflationary 1970s, Mexico, like many Latin American countries, had taken advantage of the low real cost of capital and high world commodity prices to borrow heavily in public debt markets. U.S. commercial banks had recycled petrodollars from oil-producing economies into Latin American public debt.[36] The high interest rates of the Volcker Shock undermined commodity prices and plunged the world into recession. The price of oil thus fell—one reason the Volcker Shock so diminished inflation in the United States. However, high U.S. interest rates made it more difficult for Latin American sovereigns to roll over their debts. Mexico was the most exposed country, and Citibank was the most exposed U.S. commercial bank. Chairman Walter Wriston had once quipped, "Countries don't go bankrupt."[37] But foreign investors were questioning that belief. Mexico was suffering from short-term capital flight. In June 1982 the Fed was debating whether to grant Mexico a $600 million credit line, an injection of funding that would be only a bridge loan to a much larger International Monetary Fund (IMF) bailout.

During the deliberations, Fed governor William F. Ford from Atlanta remarked that "$600 million is peanuts." The Fed must address the crucial issue, he said: "the flight of capital." In the wake of the demise of Bretton Woods, there were no longer cross-border capital controls. Volcker responded, "I don't know what is going to happen with regard to the flight of capital." Who did know? We "can speculate about everything" when it came to capital flight, Volcker informed his colleagues. It seemed that the unintended consequence of the Volcker Shock was to foil even Volcker's expectations. If any one person was responsible for the global economy at this moment, it was Paul Volcker, and if he could not answer the question, that said something about the fundamental indeterminacy that was being wired into the new political economy. FDR once knew how much gold was fleeing U.S. borders: none, because he had passed an executive order banning it.

How much money did Mexico owe to American commercial banks? Volcker asked. Vice Chairman Anthony Solomon from New York answered, "Twenty-odd billion." "Well," Volcker responded, "that's big." With capital moving across borders so quickly, a Mexican default could lead to large losses among U.S. banks and raise suspicions about the solvency of other sovereigns, threatening more capital flight and a rolling international financial panic. So the Fed approved the bridge loan, to get to a nearly $4 billion IMF bailout. U.S. banks booked losses, though not crippling ones. This would not be the IMF's last "structural adjustment" of the

Mexican economy.[38] For the Fed, global financial crisis management was to become the new normal.

An epoch was opening, much defined by short-term and potentially fickle global capital movements across space, as time horizons compressed. For that reason, global economic events became not so easy to narrate over time. Even from Volcker's chair, they were not looking very purposeful. *Volcker Shock* has another meaning. Volcker, no different from a laid-off Lackawanna steelworker, was surprised by the course of global economic events that had followed from his actions, as well as their seeming unpredictability. If capital is kept undecided, then Volcker was right: we "can speculate about everything." It was a fitting epigram for the new age.

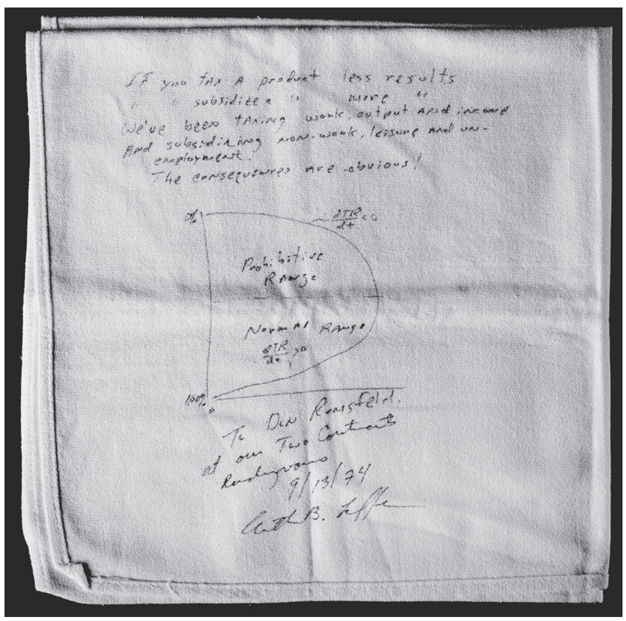
Nonetheless, the Volcker Shock had finally brought inflation to heel. The stability of the general price level did aid predictability. This achievement was considerable, not to be dismissed. A monetary tightening had mattered this much before, during the post–World War I restoration of the gold standard. But then there were also moments, like during World War II, when monetary policy played little role whatsoever in the allocation of capital. Arguably, in no era has monetary policy ever mattered so much as the era after 1980. For as capital became more liquid and convertible, the Fed's targeted interest rate became ever more a global benchmark for the flow of global investment, as the Fed—if belief in the presence of a market for a debt ever waned—became responsible for ensuring the transactional liquidity upon which the smooth functioning of one big global capital market was more and more premised.[39]

The Fed ended the monetarist experiment in 1982, returning to targeting short-term interest rates rather than the money supply—lowering interest rates if just a bit, to help ease the recession. A credit-fueled speculative investment boom now commenced, focused on asset price appreciation. But before that, first the Reagan administration made its own contributions to the new political economy.

2. Reagonomics

The Volcker Shock's consequences concentrated in capital markets. On ideological grounds, the incoming Reagan administration's policies were capital friendly and aligned with the interests of property owners. But as Republicans focused on transforming existing policies on the books, they made forays into income politics—both income security policies, and rates of income taxation. The Economic Recovery Tax Act of 1981 was the centerpiece, as the Reagan administration hoped to liberate capital on the supply side.[40]

Upon coming into office, Reagan's top policy priority had been a tax cut. Candidate Reagan's pollsters discovered that tax cuts were broadly popular, and the Reagan administration had found common cause with a new pop economic theory, supply-side economics, promoted by New York congressman Jack Kemp, in tandem with *The Wall Street Journal*'s Jude Wanniski and an academic economist named Arthur Laffer. First drawn on a cocktail napkin, the "Laffer curve" claimed to illustrate that high rates of income taxation at some threshold led to lower tax revenue, because it disincentivized economic activity, whereas lower taxes, unleashing the supply-side forces of self-interest and entrepreneurial ingenuity, led to more economic growth. By this reasoning, lowering income taxes, up to a



"LAFFER CURVE NAPKIN" (1974)

Legend has it that the "Laffer curve," or the idea that tax cuts pay for themselves through higher revenues, was invented in 1974 at a restaurant meeting of Laffer, journalist Jude Wanniski, and politicians Dick Cheney and Donald Rumsfeld. The napkin reads: "If you tax a product less results, if you subsidize it more results. We've been taxing work, output and income and subsidizing non-work, leisure and un-employment. The consequences are obvious!"

point, should lead to greater investment, more economic growth, and thus increased fiscal revenues.[41]

Kemp sponsored the Economic Recovery Tax Act of 1981 in Congress. President Reagan rolled out the plan in a February 18, 1981, speech, which polled well. Congressional Democrats, having lost the Senate in 1980 but controlling the House, responded by advocating a more "responsible" tax cut. In the end, personal income tax rates came down across the board. The top rate was slashed from 70 percent to 50 percent. The bottom rate declined from 14 percent to 11 percent. The capital gains rate fell from 28 percent to 20 percent. The corporate tax rate remained roughly level, at 46 percent. But through a new formula—10-5-3, ten years for buildings, five years for machines, three years for trucks and automobiles—capital depreciation rates for tax purposes accelerated. The tax rebate was supposed to induce greater investment, growth, and government revenue. Still, the administration projected that the tax cut would lead to a $480.6 billion loss of revenue.[42]

Would the numbers ever add up, according to the Laffer curve? George Shultz, the former Nixon Treasury secretary, then a Bechtel executive, and soon to be Reagan's secretary of state, promised the bill would have an "electric effect on expectations."[43] The 1981 tax cut was a supply-side elixir for capital. Down the entrepreneurial hatch it went—let the market take care of the federal budget. But its immediate costs were so steep that the next year Reagan and Congress had to slip in a tax increase for businesses, to the dismay of the business lobby.

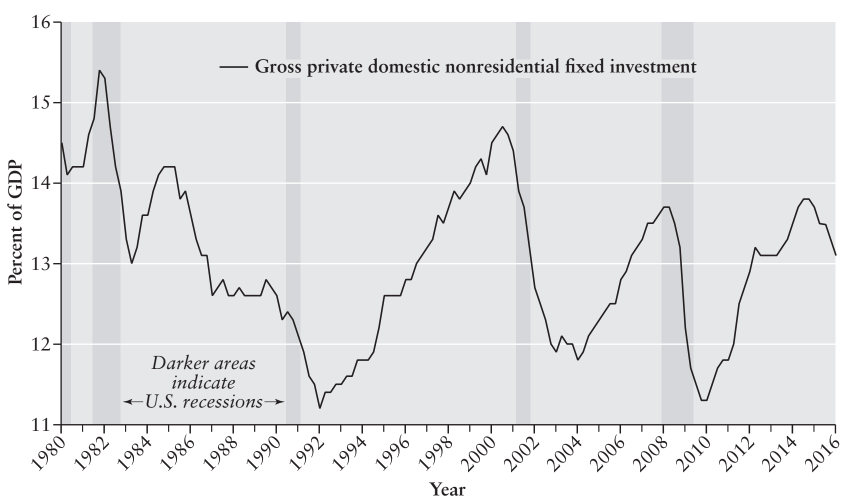
Meanwhile, on the spending side, Reagan's proposed 1981 budget called for $30 billion in cuts. For instance, the last Carter budget allotted $30 billion to farm income supports through supply management farm policies. The first Reagan budget targeted reductions of $20 billion, but they did not make it through Congress. Farm income politics proved hard to budge. When Congress was finished, after increasing military spending, the rate of federal spending growth was just barely restrained. What was cut steeply was means-tested welfare programs catering to women and children—but not Social Security. The 1981 budget slashed Aid to Families with Dependent Children (AFDC) by 14.3 percent, food stamps programs by 13.8 percent, and Medicaid by 2.8 percent. Federal eligibility criteria were also restricted, eliminating an estimated 442,000 cases from the AFDC program.[44] Employment training was cut to the bone, but states were allowed to enforce "workfare" requirements for recipients, as Reagan had when he was governor of California and had targeted phantom "black welfare queens."[45] In the midst of the Volcker Shock–induced recession, the federal government punished the poor.[46]

The federal budget aside, programmatic changes in governance accelerated some already-existing trends. Reagan's 1981 Task Force on Private Sector Initiatives promoted the privatization of public functions such as welfare delivery.[47] Government contracting with nonprofit and for-profit corporations was encouraged. For-profit and nonprofit corporations increasingly partnered up with one another and also with the state.[48] In the blending of public and private, state and market, for-profit and nonprofit, it is possible to see how the theme of transactional liquidity in enterprise—fluidity, convertibility—resonated more broadly at this time, here in the venue of governance.

3. Shareholder Value

A new macroeconomic expansion began. In many respects, it was different from those that had come before. Since the post-1982 macroeconomic expansion was the first in a new series, it is worth exploring in some detail.

This business expansion is the only one on record, before or since, in

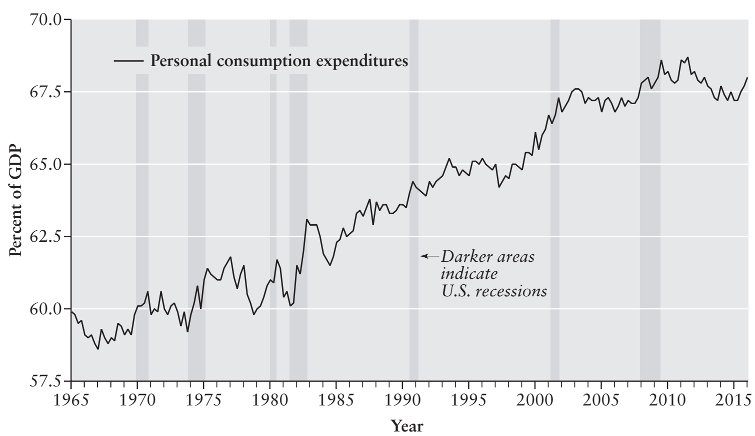


Gross Private Domestic Nonresidential Fixed Investment as Share of GDP

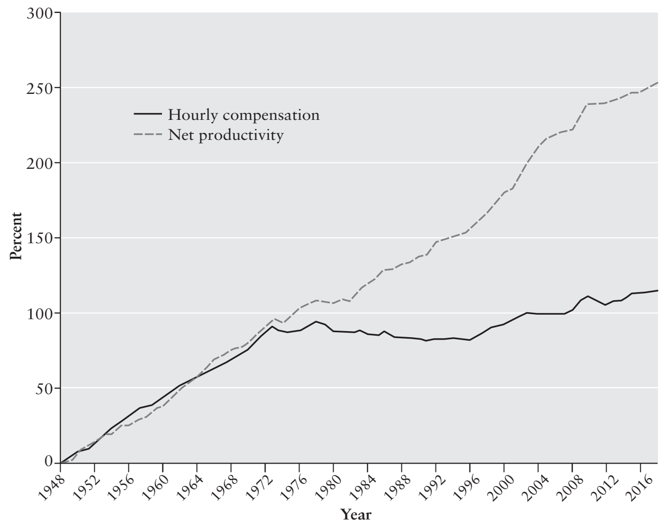
Typically, macroeconomic expansions have been led by a rising share of nonresidential fixed investment in GDP. Tellingly, the 1980s expansion featured a declining share.

which fixed investment as a share of GDP declined. Unlike what the Reagan administration promised, there was no domestic investment boom in manufacturing. Meanwhile U.S. multinational corporate investment continued to flow abroad, except now at an ever-higher rate.[49] At home, tellingly, the value of new U.S. "industrial structures" declined by one-third between 1981 and 1986.[50] Relatively, there was more speculative investment in financial and real estate assets. The post-1982 boom focused in particular on American stocks and bonds and also on commercial real estate. Notably, even for nonfinancial American firms, the ratio of net acquisitions of financial to durable assets climbed.[51] This had consequences for labor markets. As asset prices climbed, the owners of financial assets, and professionals in the business and financial services classes directly or indirectly employed by them—bankers, accountants, commercial real estate appraisers—saw their incomes swell.[52] These incomes then created fresh demand for service and care labor in the lower regions of the income distribution—say, retail, childcare, nurses, and nannies.[53] The middle began to hollow out.

Related to the declining share of investment in GDP, personal consumption accounted for a greater share. But what sustained personal consumption, if median pay growth remained flat, as it had during the 1970s, but now severed from a lower trend line in productivity growth (in part a consequence of the lower rate of investment)? There were tax cuts. However,



PERSONAL CONSUMPTION EXPENDITURE AS SHARE OF GDP
The greatest economic continuity between the Age of Control and the Age of Chaos was the increasing importance of consumerism. Indeed, in the global macroeconomy after 1980 the United States became even more so the world's most important consumer market.



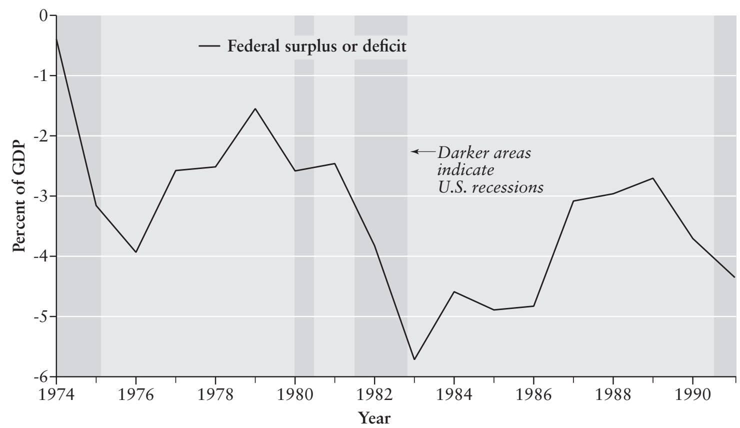
PRODUCTIVITY GROWTH AND AVERAGE HOURLY COMPENSATION GROWTH

In the Age of Chaos, productivity growth continued to disappoint, and it remained severed from average compensation growth. The benefits of productivity gains flowed to the best-off; for many working Americans to sustain consumption, debt growth replaced income growth.

unlike what Reagan had promised, a surge in the household saving rates failed to materialize. Instead, household debt increased. Effectively, household debt replaced inflation, papering over flat pay.[54] For instance, outstanding consumer credit loans, mostly credit cards, sold by commercial banks, doubled during the 1980s.[55] Conforming to the post–Volcker Shock pattern, indebted American consumers purchased the manufacturing imports of the world, financed by U.S. capital imports—in this decade, especially manufactures from Japan.[56]

Finally, another great driver of the expansion was federal budget deficits. Supply-side economics failed—the national debt expanded. Snapping up U.S. debt, however, would be a lot of foreign capital.[57]

American households and the federal government both turned to debt, but so did American corporations. Why? For one thing, credit was available in the United States—not everywhere, as much of the world economy remained mired in post–Volcker Shock public debt crises and national economic recessions. But for fear that inflation might return, the Fed kept its short-term-interest-rate target relatively high. It fell below 8 percent only in December 1984. The unusual combination of abundant available fi-



FEDERAL SURPLUS OR DEFICIT

By increasing budget deficits, Reaganomics accomplished the opposite of what it promised. But the expansion of U.S. debt would create more dollar-denominated safe assets for the global owners of capital to purchase.

nancing, but at high rates, was not seen since the 1920s, after the restoration of the gold standard. Credit booms at high rates demand quite confident expectations, and here Reagan's capital-friendly policies surely mattered. Yet, borrowing at 8 percent required a rate of return greater than 8 percent in order to turn a profit. One way to juice profits was to increase leverage, or to use more borrowed money, rather than one's own, for the investment at hand. Therefore, paradoxically enough, a credit-fueled investment boom at high rates meant snowballing debt.

U.S. corporate debt doubled during the 1980s. If step one during the Volcker Shock was the decision among the owners of capital to hoard cash and earn short-term profits through interest rate accrual, during the post-1982 expansion, step two was indebted speculative investments, to hurdle over high borrowing rates through leverage. Thus the great "discipline of the market," promised by Carter, Reagan, and Volcker alike, failed.[58] Instead, a rather undisciplined upswing in the capitalist credit cycle occurred. Its premise was the belief that transactional liquidity—a funder, if not a buyer for all assets—would always be present in what was fast becoming one big interconnected capital and credit market.

An emblematic pictorial representation was the painter Bernard Frize's *Drexel, Burnham, Lambert* (1987), named after the decade's great corporate junk bond firm.

BERNARD FRIZE, *DREXEL, BURNHAM, LAMBERT* (1987)
Named after the greatest junk bond firm of the 1980s, the painting symbolizes the increasing interconnection of capital markets during the decade.

The painting consists of one continuous line, as if there were one single market. The surface is busy, with active spatial movement, but no narrative; the line does not go in any particular direction. But different classes of objects are connected. Frize also painted the canvas with different brushes, as if to stitch together different classes of assets into a single energetic flow of credit.

The investment bank Drexel Burnham Lambert is a good place to begin to dig into the character of the post-1982 business expansion. In enterprise, the turn to leveraged asset appreciation required nothing short of a revolution in U.S. corporate governance, in which financiers, including investment bankers, continued to wrest ever more power from an already-floundering managerial class.

The weapon was the new gospel of "shareholder value," which demanded that managers act in the pecuniary interests of shareholders. That often meant slashing wages, foregoing long-term investments, or selling off assets, all in order to benefit the immediate bottom line. There was and is no hard law that says that U.S. corporations must be motivated to maximize short-term profit.[59] Most postwar industrial corporations, focused on long-term growth metrics and the maintenance of "organizational slack," had not even tried. With the shareholder value revolution of the 1980s, the present stock market price of corporate shares newly became the metric of corporate success.

What enthroned shareholder value was a wave of sometimes hostile corporate takeovers. The movement began in the late 1970s, when oilmen flush with cash from the high prices of the oil shock came to believe that the stocks of large, diversified energy companies were trading below the value of their physical assets. During his 1983 bid to take over Gulf Oil, the Texas oilman T. Boone Pickens declared in *The Wall Street Journal,* "We are dedicated to the goal of enhancing shareholder value."[60] That was one of the earliest uses of the phrase. Pickens tried to convince the majority of Gulf Oil shareholders to convey the corporation into Pickens's "royalty trust." Then he would sell off assets unrelated to the oil business, returning cash to the owners. After that, he would offer the stripped-down oil company back to the public, hoping it would fetch a high value. Pickens never acquired majority control of Gulf Oil, but management paid him "greenmail." That is, they bought back the shares that Pickens and his allies had accumulated at a price above the going market rate—far above what Pickens's group had originally paid. Boone, Houston oilman Oscar Wyatt, Jr., and New Yorker Carl Icahn, among other corporate "raiders," followed this strategy successfully. Icahn even "greenmailed" U.S. Steel.[61]

Corporate raiders could never have pulled off the shareholder revolution by themselves. They needed help in the capital markets. Joining corporate raiders were institutional investors, especially public and private pension funds. In other words, accumulations of capital that were the result of the postwar politics of pay funded changes in corporate governance that, ironically enough, undermined the politics of pay. The critical economic site shifted from income to property. If working people began to use debt to compensate for flagging pay and to sustain consumption, then leveraged buyouts demonstrated how property owners could use debt to leverage up their profits from their investments. In all, relative income growth shifted away from labor to capital.

During the 1970s, inflation had cut into pension funds' investment returns, and new state and federal laws enabled them to seek riskier investments.[62] In 1975 pension funds owned \$113 million worth of stocks. In 1980 they owned \$220 million. In 1985 they owned \$440 million. This was a perfect example of how capital began to newly traverse asset classes in this period. The fund managers in charge of these investments believed they could hedge the risk of stock market investments through new financial products. For instance, pension funds bought "portfolio insurance," in which computers automatically sold off stocks from their portfolios if stock prices declined. The academic theory behind portfolio insurance assumed transactional liquidity, "that continuous trading was possible"—that there would always be two sides for a trade, and not everybody would always be on the sell side. Furthermore, in 1982 the Chicago Mercantile Exchange began selling stock index futures contracts—essentially, an asset that tracked the price of the Standard & Poor 500 (called the "spooze"). Institutional investors, with regulators approving, bought them to hedge their stock market positions.[63]

Hedges in hand, institutional investors followed the raiders. In 1984 Texaco paid $55 million in "greenmail" to the Texas Bass family, at $55 a share when the market price was $35. The trustees of the California Public Employees' Retirement System (CalPERS), the largest U.S. public pension fund and one of the largest shareholders of Texaco, wondered why CalPERS got nothing. CalPERS led the Council of Institutional Investors (1985) and joined the chorus demanding greater corporate focus on shareholder value.[64] At all costs, the managers must focus on company stock price.

"Shareholder value" was the rallying cry for a wave of leveraged corporate buyouts and associated mergers and acquisitions. In 1982, in the midst of a revolution in antitrust law, Reagan's Justice Department changed its "merger guidelines." No longer was the goal, as stated in 1968, to "preserve and promote market structures conducive to competition." The new standard in assessing a merger was only whether its outcome would or would not "maintain prices above competitive levels."[65] This reflected the spreading influence of the Chicago Law and Economics movement, which argued that the only relevant standard for antitrust enforcement was "consumer welfare," or lower prices—not market structure or barriers to entry. Judges stripped antitrust prescriptions against vertical and horizontal mergers out of the law.[66] Between 1985 and 1989, there were thousands of leveraged buyouts, valued in excess of $250 billion.[67]

Assuming that adequate greenmail was not paid, the art of the leveraged buyout was this. Raiders and also new "private equity firms"—the largest at the time was Kohlberg Kravis Roberts (KKR, founded in 1976)—bought a portion of the target company's shares, usually between 5 and 10 percent.[68] The game had begun. Other shareholders, especially the large institutional investors, had to be willing to sell out to the acquiring interest. Management could even choose to participate, and often business consultants encouraged them to do so.[69] A company was far more likely to engage in a buyout transaction when executives from the finance rather than production or sales side of the corporation were in leadership.[70] If managers resisted, the buyout would be "hostile." To raise cash for the purchase of the shares, buyers secured credit lines from banks, or issued junk bonds—risky corporate bonds paying high yields. This was the final ingredient: the newly burgeoning debt market in junk bonds. They were what made the buyout leveraged. Investment bankers, above all Michael Milken of Drexel Burnham Lambert, made this market.[71] Finally, after investor groups built up a large stock position, it offered corporate boards a bid—a named share price—to buy out the company and take possession and ownership of it.

Thus publicly traded companies became privately owned. But the company then had to raise cash to meet the debt payments. That normally meant selling physical assets, as well as cutting operating costs—including labor costs. Spectacularly, employee pension funds, to compensate for their employees' flat compensation growth, sought yields by participating in leveraged buyouts, which then led newly indebted corporations to slash wages and eliminate jobs—so they could meet their debt obligations. Commonly, conglomerates were broken into parts, with many divisions sold off. It was a vertical and horizontal disintegration of the postwar multidivisional industrial corporation—more purging of fixed capital, more hemorrhaging of blue-collar jobs. After that, the corporation was sold back to public capital markets, hoping that the new share price had warranted the original purchase. If the stock prices kept going up, generally it had. Even if the stock price rose, did that necessarily mean that the underlying company was more valuable than it had been before the leveraged buyout? If the stock price rose, did it matter?

The last great leveraged buyout of the 1980s was Kohlberg Kravis Roberts's $31.1 billion takeover of RJR Nabisco. The CEO of RJR Nabisco was F. Ross Johnson. For a corporate manager, Johnson had long been an instinctive critic of white-collar bureaucracy. His managerial style belonged to the college frat house. Postwar managerial industrial capitalism, he decided, was boring. He put his own company "in play"—a telling term for putting together a group to tap debt markets and buy out a corporation. The ensuing saga was immortalized in the business journalists Bryan Burrough and John Helyar's *Barbarians at the Gate: The Fall of RJR Nabisco*

(1989), which launched a new literary genre—the gripping and eventful nonfiction business narrative.[72] *Barbarians at the Gate* could not have been written about postwar managerialism, as the commissioning of efficiency studies and long-term capital depreciation budgeting does not make for a page-turner. A leveraged buyout does.

In one scene in *Barbarians at the Gate,* Chicago investment banker Jeffrey Beck, the "Mad Dog," loses out to a higher bid for the midwestern conglomerate Esmark Corporation. But the LBO was his idea. That entitles him to a fee. As a joke, the managers on the deal tell the Mad Dog he will not receive a fee. Beck opens a window from a Chicago skyscraper and shouts, "That's it! I'm going to jump out the window! I'm going to kill myself!" Beck ends up with a $7.5 million fee for the role he played in the deal.

Johnson lost out to KKR in the bid for RJR Nabisco, but he still took home $53 million.[73] These monies counted as labor earnings. But the income resulted from the economic activity of leveraged asset price appreciation—the fees were hived off from the gigantic sums raised in debt markets. With such giant corporations in play, and so few individuals wheeling and dealing, with access to bank credit, enormous sums were at stake. It is hard to argue that Johnson was a better manager because of his education or talent—his "human capital." He was simply in a powerful position because of his job title and his social network, which he had leveraged as much as his own company.[74]

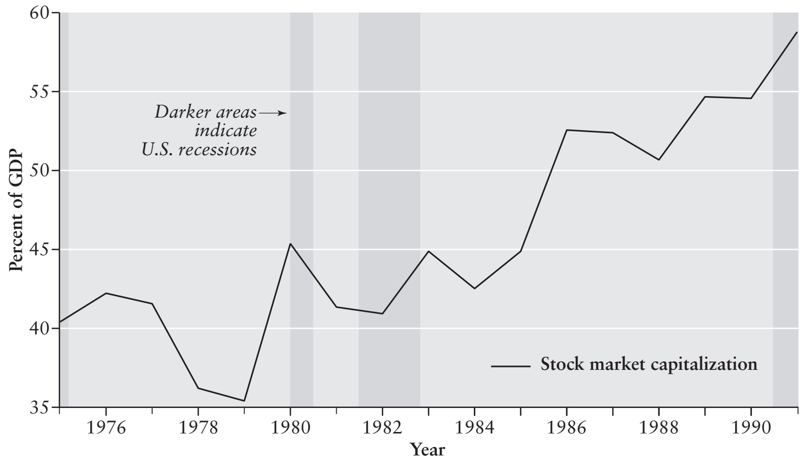
Probably the fate of RJR Nabisco was sealed when CEO Johnson decamped from corporate headquarters in Atlanta to live and play in New York City, which had reversed its postindustrial fortunes and was no longer a 1970s punch line. Wall Street quickly became an object of cultural fascination. Oliver Stone's *Wall Street* (1987) stands out among films. It tells the story of the fictional corporate raider Gordon Gekko, a combination of real-life raider Asher Edelman and the stock market speculator on buyouts Ivan Boesky, author of *Merger Mania* (1985), who told a graduating class of the UC Berkeley business school that greed is "healthy."[75] "Greed, for lack of a better word, is good," Gekko says in the film. Stone wanted *Wall Street* to be a critique of Wall Street, but the film made Gekko too likable, in part because it so well captured the obvious eroticism of the new financial dealing. Gekko passes along stock trading tips and his girlfriend to his protégé, Bud Fox. A worthy complement in the novel category was Bret Easton Ellis's *American Psycho* (1991), a satire about an investment banker misogynist serial killer.[76] Ellis raised the suspicion that there was something deeply antisocial about this financial activity, which compensated for, but did not solve, male identity crises.

Stepping back, no doubt many old industrial corporations deserved to be shut down, one way or another. And in their drudgery and danger, many blue-collar jobs, so quickly shed, had hardly been worth saving. The liquidity of capital made it possible. But where was the creation in this destruction? What did it create exactly, besides the enrichment of a narrow group of people, on one patch of the earth?

Regardless, by the mid-1980s a new "common sense" of what a corporation was had taken shape.[77] In 1976 two Chicago-trained University of Rochester business school professors, Michael Jensen and William Meckling, had published what was to be one of the most widely cited of all academic economics papers, "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure."[78] A firm, they argued, was a spot market, a "nexus of contracts." The most important contract was that between a principal (the equity owner) and his agent (the manager). The manager's job was to maximize shareholder value. Now. The standard postwar managerial profit target had been twenty years; by the mid-1980s, the industry standard for a successful leveraged buyout "payback" was two years.[79] Jensen and Meckling's model assumed transactional liquidity among all assets.[80] In 1985 Jensen left Rochester for the Harvard Business School, cheering on the shareholder value revolution, as this "agency theory" of corporations began to seep into business schools, consultancy recommendations, and popular consciousness.[81]

As for shareholder value, buoyed by debt and computer automation, NYSE trading volumes exploded during the 1980s. So did U.S. stock market prices. Stock market capitalization climbed, even though the corporate profit rate—actual business earnings—remained below that of the bear market 1970s.[82] Corporate boards, buying their shareholders' loyalty, increasingly tied managerial compensation to stock options instead of pay. Managers, in turn, began to buy back company shares, to keep the stock price up.[83] Discussions of "fundamentals"—what a business actually did—still mattered in valuation, but asset prices, throwing off capital gains, might delink from what was supposed to be their anchor in the "underlying" business profit of the firm, made from using up capital in wealth-generating enterprise and labor.[84]

But then why did the "underlying" business profit have to be founda-



Stock Market Capitalization to GDP
Over the 1980s the new political economy of asset price appreciation contributed to a rise in corporate stock prices.

tional? In the early 1980s, profits from the FIRE sector (finance, insurance, and real estate) surpassed those from manufacturing. In 1978, for manufacturing firms, portfolio income (from interest accrual, dividends, and realized capital gains) was 18 percent of total profits. By 1990 it was 60 percent.[85] Why bother parting with liquidity—bearing a risk of loss by investing in enterprise, employing labor, making a product, and selling it at a profit above cost—when one could lean back and buy and sell assets in markets fueled by debt (if not threaten to jump out of a window for a hefty fee)? At least, the line between what was thought to be reality and representation in the economy was blurring, and the latter was perhaps getting out ahead of the former—back to P. T. Barnum and confidence games.

The blurring of appearance and reality was a great preoccupation of 1980s cultural "postmodernism."[86] Take what might be considered one of the great postmodern literary genres, "mark-to-market" accounting.[87] Postwar managerialism's "historical cost" accounting had computed profit in relation to the past use of productive capital, or its long-term depreciation. In mark-to-market accounting, the present market value of assets, foretelling future incomes, is what matters. The horizon is perpetually short-term. Future "return on equity," or the trajectory of the stock, replaces "return on investment," or the return on the company's past outlay of resources, in order to produce something and sell it above its cost of production. The distant past is wiped out. So is the distant future, as the future collapses into the present price of an asset, updated by the millisecond. (In novels from this period, like Martin Amis's 1991 *Time's Arrow,* "reverse chronology," or time running backward, was a popular narrative technique.) That was what Chicago school economists' "efficient markets" hypothesis theorized: financial markets do not recognize the past, they accurately price the future into the present.[88] In cultural expression, that was what the decade's neon color palette symbolized—the intense but fleeting present moment.[89] In the sartorial style of 1980s corporate raiders, a bright color meant the power red tie. The celebrity New York real estate developer Donald Trump self-caricaturized the look.

In style, like the 1880s, the 1980s also saw the renewed prominence of the color black, made especially popular by the pop artist Madonna. Black was the color of mourning, back then arguably for the agrarian past, now arguably for postwar industrial society. Surely 1980s capital markets left postwar industrial corporate managerialism dead in the dust.

4. "Truthful Hyperbole"

The new macroeconomic pattern of the 1980s was capable of creating a sustained economic expansion. It also sponsored forms of economic life far from Wall Street. This boom looked a lot like the growth of cities such as Houston, where the economy did not revolve around the male breadwinning wage, or on long-term fixed investment and productivity growth, but rather on the spread of real estate across space, and on high- and low-wage service employment—and where the principle of liquidity spread outside capital markets and into everyday life. There was only one Wall Street. The post-1982 expansion saw the extension of the previous Sunbelt pattern of economic development across the United States.

During the 1980s, employment in the service sector grew prodigiously. Between 1980 and 1988, of the 12 million new jobs created, 2 million were in the "business services" subcategories toward the top end of the income distribution. That included everything from bankers to sales representatives, insurance adjusters, and real estate managers. Toward the middle to low end were 3 million less-skilled, lower-paying jobs in such things as food preparation, retail work, education, and health services.[90] All of these jobs, regardless of their pay, were in low-productivity regions of the economy, as commonly measured: the kind of productivity gains Henry Ford made in turning out more Model Ts per minute are not so easy to achieve when flipping burgers, cleaning bedpans, teaching aerobics, or prescribing drugs. The 1980s saw no trendline increase in productivity growth.[91] If the general price level was held steady after Volcker, there was inflation in asset prices, especially commercial real estate.

Commercial real estate was another unintended consequence of the Volcker Shock story that combined with the unforeseen results of Reagan's tax policy. Prices had bottomed out during the 1973–74 recession but had begun to recover during the late 1970s, as commercial rents, unlike many streams of income, could be updated to account for inflation. After the Volcker Shock, funding abounded. For instance, Japanese capital poured into Los Angeles real estate.[92] Latin American capital, fleeing debt crises, arrived in Houston.[93] It was at this moment that Trump arrived in Manhattan bankrolled by his Queens-real-estate-developer father, as well as friendly government tax credits. Trump, leveraging his real estate assets and no less his celebrity, built his Manhattan real estate and Atlantic City casino empire on debt, funded by a "sprawling network of seventy-two banks," including Citibank, Chase, and Bankers Trust, as well as British, German, and Japanese banks.[94] Trump was emblematic of a larger trend. He was a business concern with very little underlying income generation, relative to his assets, which he purchased through bank debt. When his assets increased in price, he used them as collateral for more loans, which became his income, given that his actual businesses usually lost money in the end. "Truthful hyperbole" was what Trump branded the business model in his ghostwritten autobiography *The Art of the Deal* (1987).[95]

Trump was the clownish though savvy extreme. But real estate was no different from the stock market. Tapping new sources of credit, commercial real estate saw its asset values during the 1980s surge far beyond what had long been considered the sector's so-called fundamentals—the construction and actual use of commercial buildings.[96] The decade's national real estate construction boom did create 1.5 million new jobs, mostly for men, in construction, although focused on cities such as Dallas or Phoenix, not Pittsburgh or Cleveland. Nonetheless, in terms of values, appearance was everywhere running out ahead of reality.

Commercial real estate was a sector where grand ideological pronouncements about the market mean very little, in comparison to some of the nitty-gritty details of the ongoing transformation. Reagan's 1981 tax cut had created a new accelerated depreciation credit for "structures." Manufacturing was the intended target, but the law also applied to commercial real estate. Companies could sell tax credits to one another.[97] The paperwork meant more jobs in "business services" for tax lawyers. Rather than building factories, even industrial corporations such as General Motors began to invest in office building construction, if only for the tax credit. Lawyers began to charter a host of new kinds of legal partnerships and shell companies. Income shifted to them, especially when the 1986 tax reform bill benefited such entities by granting them lower tax rates than corporations.[98] Liberalism had long used the tax code to attempt to induce private investment in industry, to mixed effect. The technique now became a near parody of itself, as capital moved—in this instance into leveraged commercial real estate, not industry—through mind-numbingly complex tax-friendly intermediaries.[99]

A similar story can be told about the new sources of funding. In 1982 the Garn–St. Germain Depository Institutions Act changed the financial regulation of "thrifts" in the savings and loan industry. New Deal–era regulations had highly limited thrifts' loan portfolios. In real estate, savings banks were limited largely to the residential market within fifty miles of their location. The pattern begins to look familiar. Here again, 1970s inflation undermined the industry, in this case mostly because so many thrifts' assets were old home mortgage loans with low, fixed interest rates. The 1982 law let thrifts invest up to 40 percent of their assets in commercial real estate. It increased the federal insurance limit of deposits from $40,000 to $100,000. It also allowed individuals to own thrifts. Finally, it let savings banks accept "brokered deposits" from the unregulated shadow banking sector. Money managers thus cobbled together $100,000 CDs, deposited with thrifts. There was no risk, only gain, as they were government insured.[100]

Thrifts' commercial real estate loans climbed from 7 percent of their total assets in 1982 to 20 percent by 1989.[101] Credit flowed, mostly, to the fringes of expanding Sunbelt cities and suburbs, like office parks in California and Texas. Many real estate developers chartered or acquired thrifts themselves. They might funnel federally insured brokered deposits through thrifts, into their own "pass-through" real estate subsidiaries. In this period, many commercial buildings earned the nickname "see-through" because they had so few occupants. In Houston, Gene Phillips used a shell company called Southmark Corporation to buy a thrift, San Jacinto Savings and Loan. San Jacinto exchanged $246 million worth of commercial real estate mortgages back and forth with entities of a New

York real estate developer and thrift owner, Charles Keating. Such deals were now possible. These people simply traded the same asset among themselves over and over again, each time booking profits by assigning a higher price. From these swaps, the two booked $12 million in mark-to-market accounting profits, which Keating used to fund leveraged purchases of leveraged buyout junk bonds from Drexel Burnham Lambert.[102]

Aghast, a Florida state regulator noted that "money availability" had become "more of a reason for real estate development than economics."[103] Funding was available, but interest rates were high, so debt and leverage were needed for profits to hurdle over the cost of the loan. But this was economics, or at least one way to have an economy. Commercial real estate was no frothy market on top of an underlying business expansion. Maybe, increasingly this was it: capital rushing into an asset class, throwing off income and creating jobs—for bankers, developers, construction workers, and self-employed building inspectors, appraisers, assessors, accountants, and fraudsters. Meanwhile, as median male wages flatlined and more women entered the labor force, their absence from the home and their newfound incomes created demand for more service jobs in the care sector. Someone had to cut the hair, cook the dinners, watch the kids, and tend to the elderly parents of members of the financial and business services class.

Of course, capital did not rush everywhere. As for real estate values, northern black urban property prices continued to fall, as they had been doing since the late 1960s urban uprisings.[104] Black migration back to the South advanced. But many northern urban black people—increasingly trapped in jobless ghettos, devalued by capital, and with unemployment and means-tested welfare benefits declining—had no choice but to become entrepreneurial, in the spirit of the times. The informal and criminal economies expanded.[105] The nationwide increase in violence and crime that began during the 1960s had not yet reversed.[106] In 1982 Reagan doubled down on Nixon's "War on Drugs." Rates of black male incarceration for nonviolent drug offenses surged in particular, but in general white incarceration increased at the same rate as black. The U.S. prison population climbed from around 300,000 to over 1 million by 1996. The United States became by far the most punitive state in the world. Spending on incarceration increased as means-tested welfare benefits and public housing expenditures fell. And here were some new walls—prison walls. Capital might invest in them. The first for-profit prison since the 1920s was contracted in

Tennessee in 1983: "Incarceration for profit concerned 1,345 inmates in 1985; ten years later, it covered 49,154 beds."[107] Likewise, for public housing, the Reagan administration offered tax credits to for-profit developers who built a minimum number of "low income" units.[108] Both rates of incarceration and for-profit "public" housing surged in the Sunbelt. In cities following the Houston model of economic development, it was easy to privatize—with so much new development, "public" prisons, hospitals, and other service deliverers never existed to begin with. This was the new political economy. When public infrastructure crumbled in the North, it would replace it.

From the point of view of the worst-off, economic life began to look bleak. Increasingly, incarceration was the solution to the exclusion of people from the postindustrial labor market.[109] The "overdevelopment of American penal policy" corresponded to "the underdevelopment of American social policy."[110] However, the expanding service economy did offer new possibilities.

In Buffalo, New York—to return to the site of the 1983 steel closures—the macroeconomic expansion did bring jobs. Doris McKinney, a black single mother and a former steelworker who lost a high-paying, secure unionized job, found a new job in a New York state hospital working with geriatric patients. The pay and benefits were worse, but the activity was better. "I work with geriatric patients. And I do various crafts and arts. . . . Oh I love it, I love it. I can't tell you how happy I am to be doing it. . . . This is what I would want to do for the rest of my life."[111] Health and education services added 3.1 million jobs during the Reagan years, a nearly 40 percent increase. At first, the Reagan administration had reduced the number of disability recipients and benefits, but by the mid-1980s levels were soaring again, and due to an aging population, welfare transfers during the Reagan years increased as a percentage of total incomes.[112] The public welfare state and the private welfare economy expanded in unison. In many rustbelt cities, health care replaced industry, as in households the incomes of female nurses caring for aging male manufacturing workers, paid indirectly by union health insurance plans, replaced the lost incomes of male breadwinners.[113]

A new world of service work was taking shape. It was socially interactive, consisting of affective, emotional, and care labor.[114] These kinds of service labor were still marked feminine. Few laid-off male steelworkers applied for jobs as home health care aides. Men were more likely to find jobs in "self-employment," often precarious and with low benefits. But one former GM worker at the streamlined Linden, New Jersey, plant reported that in his new job, "the relationship is better." He had hated his boss. A new self-employed operator of a laundromat noted, "It's so different now. People who come in to have their clothes [washed] are usually in a good mood, and if I'm in a good mood, too, things are rosy."[115] Because of the social content of the new service jobs, some people appreciated them, valuing them relationally. But as workers, they were not appreciated so much in distributive, pecuniary terms. A willingness to care for others did not count as appreciable "human capital," but an accounting degree from a university did. Soon economists developed a name for this phenomenon: "skill-biased technical change."[116]

Exploitation was also common in service labor markets. Acknowledging the collapsed boundary between home and work, labor unions tried to find ways to root it out. Home health care workers in New York, Chicago, and San Diego, overwhelmingly black women, fought to organize. For-profit firms could now contract to provide Medicare-funded home health care services, so workers might have to bargain with states, nonprofits, and for-profits.[117] The Service Employees International Union (SEIU), led by John Sweeney, supported such organizing efforts. The International Ladies' Garment Workers' Union created a childcare center in New York in 1983 and in 1988 won parental leave for its 135,000 members. Nonetheless, organizing workers in precarious positions, employed by contractors, subcontractors, and numerous "vendors," was not easy. From this moment onward, however, American women began to join unions at higher rates than men.[118]

5. Politics of Nostalgia

In 1984 Reagan was reelected by 59 percent of the popular vote—a triumphant landslide. It had been a remarkable number of years of dizzying economic transformation. Too dizzying? Even the Reagan administration stopped to assess and, walking pro-market ideology back a bit, participated in a new politics of nostalgia for the bygone economic order. Released months after Reagan's second inauguration, the highest-grossing film of 1985 was bathed in nostalgia for the postwar period—*Back to the Future.* In the late 1980s, even the cultural avant-garde shifted from postmodern obsession with representation to the theme of trauma from loss.[119]

Then the credit cycle finally closed, and the long business expansion came to an end.

While glad that capital imports paid for its budget deficits, the second Reagan administration began to question the post-Volcker global economic configuration. The value of the dollar was awfully high. The Plaza Accord of 1985, struck at New York's Plaza Hotel, announced to the world the commitment of the United States, Japan, West Germany, France, and Britain to intervene in foreign currency markets and bring down the relative value of the dollar. Between 1985 and 1987, compared to other currencies, the dollar declined by 40 percent—taking it about back to where it had been in 1980.[120]

Why the Plaza Accord? Japanese and European finance ministers had not liked watching their countries' savings flow abroad to purchase dollars and dollar-denominated assets. Because of the high dollar, American manufacturers' goods were more expensive abroad, while in the domestic market, the imports they competed against were cheaper. They began to lobby Congress. Moreover blue-collar job loss had become difficult for the entire political culture to stomach. Something must be wrong in an economy where female employment in health services surged, while male manufacturing employment declined. After a lag following the Plaza Accord, the U.S. trade deficit dramatically narrowed. An interregnum opened in which the post-Volcker pattern reversed. (It would come back, with a vengeance.) In the late 1980s, benefiting from the reversal in terms of trade and also from the continued halt of average real wage growth, U.S. manufacturing profits began climb.[121]

Nowhere did the politics of nostalgia play a greater role than in farm policy. Like many third-world commodity producers, many American farmers had gone into debt during the 1970s to expand production, only to be punished by higher funding charges due to the Volcker Shock. U.S. farm debt reached $215 billion by 1983. The "farm crisis" became a national story in 1984–85 and also a postindustrial media spectacle. The small family farm did not exist anymore. On free market principles, Reagan vetoed a congressional bailout. Farm lobby Democrats rolled out celebrity actresses before their committees as "expert witnesses." Jessica Lange, who starred in *Country* (1984), about an Iowa family farm foreclosure, pleaded with Congress not "to allow the last remnants of our heritage [to] disappear." *Field of Dreams* (1989), the best film about the Iowa farm crisis, had no politics, just a yearning for the past that could only be brought back, truly, by magic. In 1985 Reagan backed down and signed an expanded farm bill that distributed 80 percent of its welfare to overwhelmingly white farm proprietors or corporations that earned more than $100,000 a year. The white yeoman Jeffersonian farmer was no less mythical than the black welfare queen.[122]

Neither yeomen farming nor male industrial breadwinning was coming back. But with the return of the credit cycle, something repressed did. On a single day of trading, October 9, 1987, the NYSE's Dow Jones Industrial Average fell 22.6 percent, a historic drop. Unheard-of levels of volatility began to appear in the NYSE in 1986. Given the rise of one big, interconnected capital market, money was rushing in and out of the NYSE at unprecedented speed. "Moves like this used to take ten days to make. Now they take ten minutes. You can't get a handle on it," said one market participant.[123] When Chicago "spooze" contracts—a stock index derivative, or a synthetic asset, whose value derived from price movements in other assets—soared, money managers sold them and bought underlying stocks, driving up the NYSE. The reverse trade brought the price of stocks down. Would someone buy them, to bid them back up? Would transactional liquidity in the market be sufficient? Regulatory agencies saw no problem with the financial innovation. In 1985 a Treasury, Federal Reserve, SEC, and Commodity Futures Trading Commission report noted that a host of new complex financial derivatives fulfilled "a useful economic purpose," since "firms and individuals less willing to bear [risks]" could trade them to firms and individuals who were willing to do so. The report noted the "rationality" and "efficiency" of financial markets and concluded that derivatives "appear to have no measurable negative implications for the formation of capital."[124]

In October 1987 institutional sell orders through portfolio insurance and stock index trades leveled prices at the NYSE. At the bottom of the market, there were no buyers—no transactional liquidity. Stock markets in Tokyo, Hong Kong, and London suffered routs. On Monday, October 9, the NYSE lost 508 points. Confidence collapsed, in a massive flight to cash—now precautionary liquidity preference broke out. That undermined short-term speculation, let alone any long-term investment. The next day trading all but halted in the Chicago and New York pits. Traders wore DON'T PANIC buttons. The Fed, under the chairmanship of Alan Greenspan since August, announced, "The Federal Reserve, consistent with its responsibilities as the nation's central bank, affirmed today its readiness to serve as a source of liquidity to support the economic and financial system." Panic subsided, and confidence returned. The NYSE clawed back value.[125] The sudden crash did not lead to an immediate economic recession.

Over the decade, it had become obvious that the Fed was willing to support the new political economy of asset price appreciation. So long as markets believed in the continued presence of transactional liquidity for assets, or just for the debts that funded them, then confidence was maintained, and asset prices might continue to climb. Long, credit-fueled macroexpansions could continue. But the only agent with the ultimate power to guarantee liquidity was a state institution, the Fed. Greenspan could not have been clearer that the Fed was willing to embrace this role.

Lasting until 1990, the post-1982 expansion was the longest peacetime expansion on record since World War II, second only to the one that lasted from 1961 to 1969. Not Reagan but President George H. W. Bush oversaw the brief downturn of 1990–91. Still wary of inflation, Greenspan's Fed raised short-term rates from under 6 percent to nearly 10 percent between 1986 and 1989. The action closed the credit cycle. Leveraged commercial real estate values dropped. As a business model, truthful hyperbole perhaps had its limits. Trump went bankrupt. Leveraging his personal celebrity and not much else would soon become his business. In real estate, the fraudulent savings and loan industry imploded, ending in an approximately $150 billion government bailout.[126] Access to credit had enabled criminality. In 1990 the junk bond maven Michael Milken was sentenced to ten years in jail for insider trading. The junk bond market tanked. The leveraged buyout wave of corporations ended. Finally, in a leading cause of the recession, personal consumption decreased. Having accumulated debts, in part to compensate for weak pay growth, many households now decided to halt the rise in their indebtedness and spent less, undermining economic activity. That mattered a lot, since, after all, the business expansion had been led much more by consumption than by investment.[127]

Stepping back, let us assess the economic changes over the decade. During the 1970s crisis of industrial capitalism, almost every single national economy had experienced a malaise of some sort. Many states had turned to the capital markets, accumulating public debt, looking for salvation of one kind or another, but usually they sought to revive their industrial economies. When the Volcker Shock hit and a worldwide economic recession broke out, interest rates on funding shot up, resulting in crippling public debt crises—in Latin America and Africa especially. But even some eastern European Communist countries, Poland being the most dramatic case, had gone to the capital markets to attempt to borrow their way out of the industrial doldrums. These regimes doubled down on their investments in capital goods industrialism, in a gamble that failed. Communism would perish.[128]

For its part, capitalism transformed. Aided by the liquidity of capital, the United States, still the global hegemon, led the way. Due to the dollar's status as the world's reserve currency, the United States uniquely benefited from capital imports during the 1980s, while much of the world suffered economically. The Volcker Shock had contributed to that by raising interest rates, thus making holding dollars more attractive, and even more important, it broke the back of inflationary expectations—bolstering the confidence of the owners of capital. The United States experienced an economic boom during the 1980s, while other countries did not. (There are no Houstons in, say, France.) What an extraordinary and unique opportunity the United States had to capitalize and chart a postindustrial future.

The Reagan economy can count a number of achievements. It consigned postwar industrial society to the past. Job growth in services was prodigious. Perhaps its greatest achievement was the narrowing pay gaps between men and women.[129] Related, the post-civil-rights entry of women and minorities into jobs that white male discrimination had previously excluded them from became a significant driver of productivity growth.[130] But in general the rate of productivity growth still disappointed—in that sense, the 1980s was the worst decade on record since the industrial revolution.[131] This was much because long-term investment, private and public, was so weak (outside military investments in such things as an interstellar missile system that did not work to fight a Cold War enemy that was collapsing anyway). With money and credit so abundantly available both at home and abroad, most of what the U.S. owners of capital did during this decade hardly deserves praise: in particular, their fostering of a bloated financial sector focused on short-term speculation that was of questionable social value. It was of questionable economic value, too—finance's contributions to productivity since 1980 have been hard to find in the statistics.[132] Meanwhile, as income gains began to flow to the owners of appreciating assets more than to workers, economic inequality widened.[133] Many of the new jobs created to service the better-off were low paying, and some were exploitative. Finally, even as during this decade science confirmed the existence of anthropogenic climate change, the high-energy fossil-fuel- and automobile-based economy of the Sunbelt only entrenched and expanded.

Various economic policies had encouraged the shift, but the new capitalism was hardly the conscious result of any long-term political or economic vision. Instead, a new, persistent pattern of expectations arose, defined by a new preference for liquidity—more transactional liquidity, as in more convertibility across assets, often to aid busy eventful speculation that had no particular purpose or end beyond itself. Paradoxically, a liquidity preference for money or money-like assets generates speculative uncertainty and also offers a potential response to it—the precautionary hoarding of liquid, safe-haven stores of value, as a lull from any moment of disquietude, which have the added advantage of providing the opportunity to instantly jump back into the speculative game. Thus whether seemingly busy or literally inactive, a high liquidity preference may trap economies in some version of a short-term horizon. Meanwhile, in lieu of taking a long view, the politics of nostalgia directed gazes backward, to a past that was not coming back and did not deserve to anyway. Outside the movies, there was no going back to the future.

Altogether American society saw a loss of control, and of a capacity to deliberately create economic outcomes. One "can speculate about everything," Volcker had surmised off-record in 1982, after becoming arguably the world's most important economic policy maker. "I don't know what is going to happen with regard to the flight of capital," he confessed in private to his colleagues. American workers who lost their factory jobs during the 1980s but landed on their feet, finding new work in services or self-employment, were often quick to qualify it: "I got lucky," "I lucked up," "I lucked out."[134] "I guess there's good opportunity if you can get a good education," said former steelworker Benjamin Boofer, who now cut firewood. "But it looks a little bit to me that everybody is going to have to be smart and then the ones that get it are going to be lucky."[135]

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