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Abstract

In this thesis I have set out to establish how the post U.S. socio economic order or more often known as the U.S. “Golden Age of Capitalism” came to an end, and what the ramifications of this event are today . I have defined this socio-economic model as being one of a social democratic nature, with a strong commitment by the Federal Government to intervene in the market ever present.

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Chapter 1

Keynesian Framework of the Golden Age

In formulating an assessment of how the U.S. “Golden Age Of Capitalism” was brought to an end, it is vital that we consider the monetary and economic framework that emerged after the end of the Second World War which formed the economic foundations of this socio-economic model.

(Harvey D, 2006) states that in the USA,

—the share of the national income taken by the top 1% of income earners fell from a pre-war high of 16% to less than 8% by the end of the Second World War and stayed close to that level for nearly three decades”

Following the end of World War Two the USA entered a 25 year period of unprecedented economic growth dubbed “The Golden Age of Capitalism”.

The sixteen years preceding the end of the war constituted an era of almost continuous national economic emergency, including 12 years of economic depression which would end only after 4 years of American engagement in World War Two (Harvey D, 2006).

As Robert Dahl and Charles Lindblom argued in 1953, both capitalism in its pre-World War Two form and Communism had failed. The only way forward for society was the construction of an economic system based on the right balance between state, market and democratic institutions to guarantee peace and stability, based on the inclusion and well-being of its members (Harvey D, 2005, p.10). Underpinning such a system was the commitment to fight recession/depression via Keynesian demand management.

In no way was the now absolute unshakeable belief of the nation in Keynesian Demand Management (a role the state had been forced into practicing on a sufficient scale during the war) more clearly defined than in the Employment Act of 1946. The act declared; *—that it is*

the continuing policy and responsibility of the Federal Government to use all practicable means . . . to promote maximum employment, production, and purchasing power."²

Such policy formulation is necessarily a total endorsement of Keynes' "Principle Of Effective Demand", as stated in his masterpiece *—The General Theory Of Employment, Interest and Money*".³

Keynes held as the basis of his theory of employment that *—the amount of employment, both in each individual firm and industry and in the aggregate, depends on the amount of the proceeds which the entrepreneur expects to receive from the corresponding output*".³

Keynes wrote that the average supply price of output from labour employed may be expressed as $Z = f(N)$, where Z (the supply price of output produced) is a function of N (labour employed), with the inverse equation being termed the "*Aggregate Supply Function*".³ Correspondingly, the proceeds entrepreneurs may expect to generate from the employment of a given amount of labour may be expressed as $D = f(N)$ where D (the proceeds of the output) is the function of N (labour employed).³

Keynes held that if for a given value of N proceeds (D) may be expected to be greater than the value of Z (supply price), then entrepreneurs will ultimately increase N (employment) up to the value where $Z = D$, where profit maximisation is achieved.³ Therefore the equilibrium level of employment is denoted by the value of D at the point of intersection between the *Aggregate Supply function* and the *Aggregate Demand Function*. The value of D at this point is dubbed *—the effective demand*".³

Keynes held that *in a given situation of techniques, resources and costs* the level of income depends on the level of employment. Because the difference between the propensity to consume and the propensity to save generally represents a net leakage from the economy, savings must re-enter the economy as investment at a level where the rate of investment equals the rate of saving for demand to stay constant, while if either one of these, or both, rises above the overall demand level, the economy grows and demand for labour increases. Keynes therefore held that Demand, $D = D_1 + D_2$, where D1 equals the consumption by labour itself and D2 the level of investment by investors and business people.³

Therefore, it is based on this theoretical framework that the employment Act of 1946 undertook to engineer demand through increases in the federal deficit in times where it had fallen down, so that the nation could be steered back towards the level of effective demand and corresponding full employment. The unilateral commitment to such policy formed the basis of the post-war U.S. economic policy.

Chapter 2

Bretton Woods and its End

In July 1994, the allied nations met at Bretton Woods to hammer out a new international monetary order. With the avoidance of a 1930's style collapse of international trade in mind, whereby currency devaluations and trade restrictions implemented by nations lead to the

virtual collapse of international trade throughout the 1930's, the main task of those who met at Bretton Woods was the adoption of an internationally accepted currency that would facilitate world trade.

The agreement reached was to represent a compromise between Keynesian and neo-classical monetary theory. Keynes argued for an international currency to be called "The Bancor" whose purpose it would be to automatically transfer finance from balance of payments surplus to balance of payments deficit countries. Keynes' belief was that this would ensure the ability of deficit countries to be able to continue engaging in trade without the need to deflate their economies should balance of payments problems arise. Correspondingly, surplus countries would be guaranteed continually expanding markets under this arrangement. This policy was to be enforced by a pan capitalist international clearing union that would act over and above the wishes of individual capitalist states. All States, in Keynes' view, would have an interest in maintaining this system as it would guarantee the maintenance of "effective demand" throughout the global economy (Kiely R. 2009, p.49).

Keynes' ideas were rejected, in particular by the United States and so it was that the dollar was made the world reserve currency and international means of payment with all currencies fixed against the value of the dollar and the dollar valued at \$35 for an ounce of gold (Kiely R. 2009, p. 50).

This policy did not seem unreasonable in this day and age, and indeed would appear to have been quite practical as the United States held $\frac{3}{4}$'s of the world's monetary gold stock at the time and the other currencies of the world were considered inconvertible (Meltzer A.H., 1991, p.56). Economic instability at the time was thought to be caused or exacerbated by a lack of internationally acceptable currency i.e. dollars (Kiely R. 2009, p.50).

U.S. priority then was the running of continued balance of payments deficits, foreign redistribution of the gold stock and foreign accumulation of dollars with the aim of creating a viable international monetary system (Meltzer A.H., 1991, p.56). Therefore, in the early years of the Bretton Woods system falling U.S. gold reserves were seen as favourable and the fall in the share of global gold reserves held by the U.S. to 50% in 1960 was deemed encouraging and seen as synonymous with the current account convertibility established in many of the industrialised nations' currencies by 1959 (Meltzer A.H., 1991, p. 57)

The U.S. policy of continually running balance of payments deficits obviously rested on the assumption that U.S. competitiveness would remain unrivalled and that dollars would return to the U.S. in the form of trade surpluses despite the deficit on its balance of payments. Doubts about the competitiveness of the U.S. economy and the corresponding continuation of U.S. balance of payments deficits based on its competitive position began to mount overtime however and the final economic report of the Eisenhower administration in 1960 discusses competitiveness problems in the American steel and car markets and increasing amounts of U.S. Foreign Direct Investment (FDI) abroad (Meltzer A.H., 1991, p. 58).

By the mid 1960's the U.S. was running constant trade deficits with its two main competitors Japan and Germany. Competitors in Western Europe no longer needed as many dollars to

purchase the goods of the U.S. and so “Eurodollars” began to stockpile in European banks, reflecting the declining competitiveness of the U.S. economy, for where Europe to be buying more U.S. products these dollars ultimately would have returned to the U.S. as currency for the purchase of its exports (Kiely R. 2009, p.58). These Eurodollars fell outside normal domestic U.S. banking regulations and so banks that had access to these dollars could pay higher rates of interest, lend money more cheaply and still make higher profits (Kiely R. 2009, p. 58).

The emergence of the Eurodollar market was the subject of a mixed reception from the U.S. government. It provided a market for U.S. capital but had the potential to undermine the value of the dollar (Kiely R. 2009, p.59). Many MNC’s (Multinational Corporations) began to establish plants in Europe, taking advantage of the higher productivity of industry on the continent relative to the United States where productivity began to decline due to the inability to absorb increasing amounts of new technology. Eurodollars became a cheap source of finance to expand their operations.

The major flaw of the Bretton Woods systems was by now becoming all too clear. Foreign trade and payments imbalances were growing with the recovery of the world economy and the demand for reserves was increasing. This could be met by increasing foreign holdings of dollars and a decline in U.S. gold reserves. However when the post war recovery of the world’s other economies had gained significant enough momentum for their currencies to be made convertible once again demand for reserves soared and the United States was losing gold and gaining liabilities at a rate that fundamentally jeopardised the system (Meltzer A.H., 1991, p.57)

However this is not to say that a current account *deficit* was the problem for the U.S. at this time, for since 1944 the current and trade account had been in continuous *surplus*, rather it was as states *—The problem was that the trade and current account surpluses were not large enough to finance net private investment abroad plus military, travel, and foreign aid spending abroad—* (Meltzer, 1991, p. 58). As U.S. gold reserves declined and liabilities increased rapidly from 1964 onwards concern quickly mounted that U.S. liabilities would eventually rise too dramatically for the price of the dollar to be fixed at \$35 to an ounce of gold.

John F. Kennedy had been elected on his promise to “get the economy moving again” following the recession of 1960-1961. This was to see numerous tax breaks come in, faster tax related depreciation rates on capital, investment tax credits and later sharp decreases in both income tax and corporation tax. The Kennedy administration attempted to prevent large scale capital outflows from the U.S. by maintaining the higher interest rates the administration had inherited. This was to be done by the Treasury, in co-operation with the Federal Reserve, issuing short term treasury bills, therefore attracting in private funds, while it bought the long term bonds of U.S. government debt. Therefore federal funds rates could be kept at their current level, rising slowly, while the premium to be paid on U.S. government debt could be kept artificially low, despite its enactment of expansionary fiscal policies related to tax cuts and the future cost of the Vietnam War.

All this however, was to be achieved by a high and increasing expansion of the monetary base. The Federal funds (the base rate at which the fed lends money to commercial banks) increased slowly and did not exceed 3% until 1966 (Meltzer A.H. 1991, p.59). By mid-1963 the growth rate of the monetary base was consistently above the growth rate in the output of the economy, at 3% per annum and this continued to rise in 1964 (Meltzer A.H. 1991, p.59).

This came against the backdrop of the London Gold Pool which was formed in conjunction with the other 9 industrialised European nations of the “G-10” by the United States. The purpose of the London Gold Pool was to maintain gold convertibility by their central banks purchasing gold when it fell below \$35 an ounce and by selling gold when it rose above \$35.20 an ounce.⁸⁻¹

In the short term inflation remained low and the economy recovered well during the early 1960s. In 1963 the U.S. began a period of strong economic growth while inflation increased moderately, between 0.75%-2.0% annually (Meltzer A.H. 1991, p. 60).

The increasing expansion of the monetary base over and above the productive capacity of the economy, combined with rapidly increasing U.S. government deficits resulting from tax cuts in concert with massive increases in spending on the Vietnam War and Great Society programmes, was to set the stage for later high inflation however.

From 1965 U.S. industrial capacity could not grow quickly enough to cope with rising demand. Inflation took off and the current account surplus generated by the slower rate of U.S. CPI growth to the trade weighted average, began to rapidly decline (Meltzer A.H. 1991p.67). It is important to remember that the rise in inflation was not merely a rise in prices in terms of dollars but also a rise in terms of the price of gold. This had the effect of exporting inflation throughout the world as countries were obliged to buy all offers at a fixed price (Meltzer A.H., 1991, p.67) The increasing U.S. government deficit and the constant expansion of the monetary base, in conjunction with its massive balance of payments deficit ensured this was to be the case.

Matters came to a head between the 9th-11th September 1966 when the Federal Reserve was forced to raise its interest rate to 6.13% from a level of only 1.5% in January of that year.⁸⁻² This was the culmination of the “crowding out” of the market whereby different sectors of the economy were all competing for ultimately finite amounts of credit at a time when the U.S. government was consuming it vociferously due to the on-going expense of the Vietnam War. The idea behind the rate rise being that the other competitors within the economy for credit would be squeezed out of the market place, with the federal government’s access to credit open once again. This move was to spark the “mini recession” of 1966-67 in the U.S. and caused the greatest recession in West Germany since the end of WWII. Fearing an economic crisis the Fed lowered its interest rate back down to 3.25% by 10th May 1967 and began to purchase treasuries once again. ⁸ Inflation was lowered and the economy came out of recession but in the absence of the possibility of devaluation of the dollar relative to gold, the vicious circle of monetary base expansion to pay for U.S. deficits had started in earnest once again.

On March 5th 1968 as the world financial markets became aware of Lyndon Johnsons planned escalation of U.S. forces in Vietnam, the U.S. was forced to sell 100 tons of gold on a single day to maintain the level of dollar-gold convertibility.⁸

On March 15, 1968, Britain announced, following a request from the United States, that the London gold market would temporarily cease operation. During these two weeks though, the London Gold Market was abolished.⁸

By the summer of 1971 the price of gold was rising well above \$40 an ounce and the central banks of the world's other countries began to rapidly exchange their holdings of dollars for gold.⁸ Switzerland exchanged \$50 million for gold in July. France further depleted the gold reserves of the U.S. on 5 August 1971 by exchanging \$191 million for gold.

By this stage the U.S.'s positive current account surplus had declined from \$10 billion in 1947 to \$6.6 billion dollars in 1964 and then to only \$0.6 billion in 1968. While the U.S. had ran constant deficits in the balance of payments from 1950 onwards, they began to balloon in the late 1960's, increasing from -\$2.5 billion in 1968 to a whopping -\$19.8 billion in 1971 and it was in this year also that the U.S. current account went into deficit also (Meltzer A.H. 2009, p.65) This came as a result of positive trade and current account surpluses not being sufficient enough to make up for the overall loss on the overall balance of payments.

The problems faced by the erosion of U.S. competitiveness within the Bretton Woods System and the effect the balance of payments deficit was having on labour and society in the U.S. are put into clear context by George F. James in an editorial forward written by him in the January 1st 1971 edition of *The Columbia Journal Of World Business*;

—Within the United States criticism of its own MNC's is on the rise: new investments overseas, especially in Western Europe, do not produce a return flow of profits sufficiently large and rapid to justify their continuance in the face of an adverse balance of international payments; even though return on foreign investments may be a major source of national wealth, it is inadequate recompense for the weakening of the U.S. competitive position in foreign trade; U.S. foreign direct investment —exports jobs” (James G.F., 1972, p.1)

For it was that the adoption of the dollar as the world's international reserve currency rested on a policy of continued balance of payments deficits by the U.S. state. Crucially this was to be achieved, and thought to be beneficial by the U.S. because the constant balance of payments deficits ran by the U.S. from 1950 onwards were to consist of capital account deficits in return for major surpluses in the current account and balance of trade on the assumption of the continued competitive dominance of the U.S. in international trade. This fact combined with the above cited quote by James provides us with a clear view as to the timing of the end of gold convertibility of the dollar by Richard Nixon on the 15th August 1971.

So, effectively the jig was up. The continuation of Bretton Woods and the gold convertibility of the dollar could no longer be tolerated by the U.S. as a trade-off whereby the U.S. ran

balance of payments deficits with the rest of the world in return for trade surpluses and continued U.S. economic expansion and political hegemony.

Chapter 3

Stagflation

Stagflation posed a unique threat and found both the U.S. and the world in uncharted economic territory;

—The traditional patterns of unemployment accompanied by deflation and of full employment accompanied by inflation have been superseded by a new and surprising phenomenon—stagflation”, which governments are apparently powerless to do anything about”¹⁰⁻¹

Such a situation necessarily threatens the demand management policies that formed the central plank of the U.S. post-war consensus. The mentioned rendering of government useless in such a staunchly inflationary environment is derived from the fact that were the government to implement the traditional policy of increasing the deficit to combat unemployment, inflation would rise only further therefore aggravating the situation.

The stagflation of the 1970's has in many cases mistakenly been considered to have occurred due to the oil shocks of 1973 and 1979. As (Barskey and Killian, 2002) point out there were across the board rises in the prices of industrial commodities before the OPEC crises' with these rises being synonymous with economic boom fuelled by monetary expansion, rather than commodity specific supply shocks in and of themselves.¹⁻¹

Rather it was excessive monetary expansion that was the culprit of the stagflation of the 1970's. Upon becoming President in 1968 Nixon wanted to ensure that the tight monetary policy which inspired the recession that began in April 1960 did not occur again, for in his book *Six crises* he blames it for having effectively handed John F. Kennedy the election in that year (Hancock R. 2004)

Nixon appointed Robert Burns as chairman of the Federal Reserve in 1970 with a view to ensuring that he maintained a cheap and plentiful supply of money and credit right through to the 1972 election. Nixon even ordered White House staffers to monitor Burns. When Burns would not guarantee the implementation of monetary policies that would guarantee full employment in time for the 1972 election disparaging newspaper stories were planted about him in newspapers and the administration even threatened the Federal Reserve board with the flotation of an idea that would dilute their power (Hancock R. 2004)

This politically motivated move was recklessly irresponsible as inflation in the year of Arthur Burns' appointment (1970) was running at a level of 5.6% (Hancock R. 2004) In fact, in the absence of sufficient monetary tightening inflation was to average 5.22% over the period.

Not all the blame is to be laid to rest at the feet of Nixon however, excessive monetary expansion as I have cited prior to this had been a feature of the 1960's. Rather, the stagflation of the 1970's was to be the culmination of the excessive degree of monetary expansion

during the 60's right through to the early 1970's, although the early 1970's marked a period of particular excess.

It is important to analyse clearly the implications of the 1970's stagflation induced recession. As is mentioned at the beginning of this thesis, the post war level of wealth accruing to the top 1% in the U.S. stood at 8% after WWII and remained at that level for nearly three decades until the 1970's. For the upper classes, this arrangement suited as the era was one of high economic growth, therefore the wealth accruing to the richest strata of society was more or less constantly increasing despite their overall share of national income remaining stable. However, when the economic malaise of the 1970's took route this share of overall wealth began to fall precipitously as the relative value of their assets collapsed. (As Harvey D., 2005, p. 15) states; *—The Upper Classes had to move decisively if they were to protect themselves from political and economic annihilation—*. The fight against stagflation was to form a covert vehicle in which the U.S. upper classes could pursue this goal. The victory of Ronald Reagan over Carter in 1980 was to prove decisive.

From October 1979 onwards, Paul Volcker, chairman of the Federal Reserve, began a drastic shift in Fed monetary policy. Inflation was to be battled using any and every means available no matter what the cost to employment or society in the short to medium term. The real rate of interest, which had been negative due to the extreme degree of inflation in the 1970's, was raised nominally to 20% by July 1981 (Harvey D, 2005, p. 23).

This incurred a massive recession, yet Volcker maintained that it was a necessary evil to cure the U.S. and the world of the stagflation which had dominated economic life in the decade preceding.

Chapter 4

The Reagan Era and De-Unionisation

During these two years Ronald Reagan was elected president in 1980. Moody, K. writing in the socialist register in 1987 characterizes brilliantly the course of policy events during the Reagan era;

—The first six years of the Reagan administration have been unique in post war American political history both for the ideological consistency of its leadership and for the degree to which it succeeded in altering the direction of social policy. Unlike past Republican administrations the Reagan Team has made no ideological moves toward or concessions to the political centre—
(Moody, K. 1987, p.1)

The agenda of the Reagan era may essentially be considered as having been that of big business. The agenda had essentially been worked out and organised for during the 1970's with a shift in the balance between the forces of labour and capital that occurred during these years following necessary and sensible deregulation of various sectors of the economy. The point of this however is that "capital" i.e. big business sought to effectively push the boat out further in favour of their wishes. By the late 1970's organised big business as represented by the Business Roundtable and Corporate Political Action Committees had won over the

majority of Small and medium sized enterprises (SME's) to its agenda. However, this is not to say that it was merely the Republican party that was to be captured by their agenda and that the storming of the Republicans to political power would be the be all and all of seeing their agenda implemented. Big business had by the late 1970's won over the majority of the Congressional Democratic Party to their agenda also.

With society at large experiencing the necessary pain of this massive interest rate increase so called "special interests" i.e. labour unions became very easy for Reagan to target and ultimately defeat. After a long strike Reagan defeated PATCO, the air traffic controllers Union in 1981 (Harvey D., 2005, p. 25). The 13,000 out of 17,500 air traffic controllers who went on strike were dismissed and the union itself destroyed (Meister D, n.d.)

The anti-union culture and political framework promoted by Reagan was to directly affect class relations by leading to an increasing share of wealth going to the upper classes of American society at the expense of the Nations' workers. While Union membership never exceeded its high point of 35% of American workers in the 1950's this still significant share affects non Union employees also. As (Western, Rosenfield) argue, Unionisation institutionalises the norm for fair pay while employers may raise wages to avert the threat of Unionisation.¹²⁻¹

Perhaps why the defeat of PATCO is the example of anti-Union action by the Reagan administration held most widespread in the popular conscience is because it marked a turning point in the treatment of unions by the Federal Government. The knock on effect of this action being that it signalled the precedence for a future labour relations climate where employers would be free to effectively deny the collective bargaining rights of workers.

Concrete, institutional measures as regards reducing the power of labour unions in the context of labour relations were taken to this end. Reagan appointed three management representatives to the National Labour Relations Board [NBLR], the body that oversees union representation elections and labour-management bargaining. Amongst the appointees was NLRB chairman Donald Dotson. The House Subcommittee was to find that under Dotson the board had abandoned their legal obligation to promote collective bargaining rights in what marked "a betrayal of American workers".¹²⁻²

The ruling of the subcommittee came with good reason. The NLRB under Reagan settled only half as many Union complaints as it had under Carter with employers emerging victorious in ¾'s of settled cases. Complaints were mostly concerned with employers who responded to attempts at Union organization by illegally firing Union supporters. The NLRB generally did no more than reinstate workers with back pay yet rulings generally came after an average of three years.¹²⁻³ In any case, 1 in 10 Union Workers in America were to be fired illegally during the 1980's.^{citation needed}

We may consider the judgements of the NLRB as affectively a metaphor for the overall attitude of the State towards the different segments of the socio-economic strata; in a situation where the interests of the big business elite and those of the ordinary working masses were to collide, the interests of big business and the economic elite were to win out time and time

again. The repression of the demands of the masses for better pay and working conditions in favour of lowering costs (and the upward distribution of profits) within business became official Federal policy.

Secondly, not only where the actions of independent groups such as Unions suppressed in the extreme during Reagan's tenure but increases in the minimum wage (widely regarded as being the benchmark for wages generally) were to be largely abandoned by the Federal government from the 1980's onwards. This was a direct assault on the post war-socio economic model by the administration and the political establishment generally as the Federal government had been held as the main protagonist in setting the wage floor since the passing of the Fair Labor and Standards Act (FLSA) of 1938. In fact such was to be the inaction of the Federal Government from the 1980's onwards that a pattern of States passing their own minimum wage increases was set in motion (Whittaker et al. 2012, p. 626). However this has been the furthest from compensation to America's least well off workers one could possibly imagine.

(As Whittaker et al. 2012, p. 630) writes;

—The real value of the minimum wage reached its high water mark in 1968, peaking at approximately 56% of the average hourly wage. Since then, the real value has eroded due primarily to inflation and the sporadic nature of federally mandated increases”

Justifications for this situation on the right have been as lengthy as they have been breath taking in their uncharitable nature. Sophisticated arguments have been used to underline their ideological approach of class dominance in seeing minimum wage increases be abandoned. They state that wage increases modestly reduce employment particularly for “vulnerable groups” (of course they seek to help these people) whilst simultaneously lowering the average number of hours worked throughout the economy due to the higher costs to employers of employing labour.

In reality however these arguments have done tremendous damage to the incomes of average working Americans and have been instrumental in hugely upward directed distribution of new wealth created in the U.S. since the 1980's. In a series of studies, Card and Krueger (1995) reported that state and federally mandated increases can result in higher take-home pay for affected workers, and while employment increases did not consistently achieve statistical significance, they were “uniformly positive” (Card and Krueger, p.389)

Chapter 5: New York Financial Crisis: A Sign Of Things To Come

However, all this is in no way to say that the ideological undercurrents that underpinned such neo-liberal U.S. policy implementation during the 1980's had not been bubbling under the surface throughout the decade of the 1970's. Rather, they were the penultimate concrete manifestation of an ideological shift in policy that had begun in earnest.

The most shining example of this point is most certainly the financial crisis that faced New York City in 1975 and how it effectively went on to act as a blueprint for neo-liberalist IMF intervention in many countries around the world.

Fears had been mounting about the sustainability of the city's finances since the mid 1960's when the states debt was downgraded. While New York continued to borrow at rates in excess of similarly rated areas, appetite for the city's debt was maintained.

However, by July 1974 New York's Comptroller was coming into conflict with holders of the cities debt over the high interest rates the city was now incurring on said debt. An October securities issuance met with poor demand from investor's and the underwriters made a loss. By February 1975 a sale of tax anticipation bonds had been cancelled due to the backing out of the underwriter and banks began to sell their own holdings of NY's debt.

While the city indeed managed to carry out smaller debt issuance's to the tune of \$500 million dollars in the intervening period underwriter's grew more and more wary of carrying out such issuances throughout March. However, when the Urban Development Corporation defaulted on bondholders with the backing of the state legislature, choosing to pay contractors and supplier's instead. The message was in effect clear to the underwriters of the cities debt. New York was not going to launch massive cutbacks in public spending and in its social welfare budget in order to pay back holders of the cities bonds.

The city then attempted to move much of its debt off balance sheet into a special purpose vehicle dubbed the Stabilization Reserve Corporation, which in turn would lengthen the maturity on outstanding city debt. Unhappy to meet the city halfway i.e. to allowing them to get their financial house in order, whilst enabling them to borrow to maintain reasonable levels of public and social expenditure, the banks challenged this action as an unconstitutional attempt to bypass the debt limit and so the city was forced to drop the measure.

In April 1975 New York State established the Municipal Assistance Corporation (MAC) to raise funds for the city, with the state legislature passing legislation that enabled the MAC to directly collect sales and stock transfer taxes from the city and use them to underwrite debt raised on the cities behalf. The markets rejected this measure and of the \$3 billion dollars in planned bond sales the MAC was only able to sell \$2 billion of these. Even then, they could only manage to sell these bonds at an interest rate of 11% when an index of municipals at the time yielded 6.89% in interest.

It was with this that the state now stepped in to the effect that the democratically elected government of New York was to be rid of its legitimacy, in a pattern that has been repeated in the manner in which the IMF have dealt with countries in trouble ever since. The establishment of the Emergency Financial Control Board by the state legislature saw the establishment of an organization that was to maintain direct external control over all the cities financial affairs, while under the terms of the creation of the EFCB the city was to balance its budget within only three years (despite an admitted deficit) of \$75 billion.

However, the city remained shut out of the markets and it was at this stage that the Federal Government was eventually forced to step in, effectively dragged kicking and screaming into providing financial assistance to the democratically elected authority of the country's largest city. (Harvey D, 2006) states that Secretary of the Treasury William Simon saw this as an

opportunity to restore class power in stating openly that; “*he wanted New York City to suffer so badly that no other city in the nation would ever dare take on social obligations in this way again*”.²⁻¹

The fact that the House Of Representatives only managed to pass legislation providing financial assistance to the city by a majority of ten votes shows that there were many on his side.¹ The huge support in Congress, that the maintenance of government and society within New York be left to the dictations of the financial market shows a major move away from the solidarity of the post-war consensus towards a neo-liberal, laissez fair socio-economic model.

Conditions of the loan of \$2.3 billion (provided at interest of 1%) were relatively harsh with the city forced to introduce tuition fees for the city’s university system for the first time and public service numbers slashed by 20%.^{2-2, 1} Taxes in the city were raised by \$200 million¹ and crucially, under the terms of the bailout, institutions were established that had first rights to city tax revenues in order to pay off bondholders, with the remainder going into essential services such as health and education etc.

It was, in essence the classic form of neo-liberal economic “shock therapy” that was to be replicated in the policies of the IMF for years to come. For New York was to implement these changes in only 3 years, with the bailout forcing the city to access private funding by 1978¹.

The underwriters were vindicated in their original tactic of refusing to purchase securities and in challenging the establishment of the Stabilization Reserve Corporation for a number of reasons. The settlement agreed under the brokerage of the Federal Government indeed did see the Wall Street banks turn in \$819 million of their held bonds in return for MAC bonds and/or the interest rate lowered and maturity of debt extended¹. However, one must take into consideration that they were to in no way incur any actual *loss* under this arrangement in the form of a negotiated partial default, which would surely have lowered the financial burden placed on the City of New York and its people. Also, they now had the added insurance that in the event of the city again running into fiscal problems the State and Federal governments would step in to ensure they were paid back, whatever the cost to society.

This can best be summed up by the statement of (Harvey D, 2006);

*—It established the principle that in the event of a conflict between the integrity of financial institutions and bond holders on the one hand and the well-being of the citizens on the other, the former was to be preferred”*²⁻⁴

Certainly the New York City author had widely overspent during the 1960’s. However the fact the city paid higher rates of interest on their bonds than did other similarly rated authorities indicates that many in financial circles knew full well of the city’s growing long term fiscal problem but that the underwriters continued throughout the period to ignore such information given the profit motive attached to such underwriting activities. Therefore, the non-imposition of actual losses upon those banks that were effectively complicit in the creation of New York’s fiscal crisis can only be seen as an abdication of the principle of shared responsibility between lender and borrower. This has occurred in situations ranging

from the recent US foreclosure crisis to the dogged insistence of the ECB that the Irish state repay the privately held bonds of its troubled banks. The assertion by Harvey that *“Fiscal redistributions of benefit to the upper classes resulted in the midst of a general fiscal crisis”*²⁻⁴ is a phenomenon that is alive and well in the world in which we live today.

Chapter 6 The Reagan and Clinton Era’s and Financial Deregulation

The position of finance as being untouchable within the NYC financial crisis and its ability to dictate what elected representatives of the people do in relation to their wishes was a dangerous precedent set as a result of the crisis. This phenomenon of extreme amounts of power being devolved to the financial industry was to become more pronounced during the Reagan years and made practical state policy.

What was to happen as a result of financial deregulation during the Reagan era may essentially be viewed through the prism of Stigler’s 1971 essay *“The theory of economic regulation”*. He states that deregulation may be viewed as a political market composed of a demand side, the financial institutions, and a supply side, political representatives. Accordingly, when supply side provides greater relaxation of regulation to the demand side, they do not necessarily act in the best interests of the general welfare. This is because when governments offer the group whose effective demand for de-regulation is highest i.e. the financial industry, the benefits are thus captured by those with the largest stake in seeing deregulation occur i.e. the financial industry itself! (Cornett and Tehranian, 1990, p. 96).

The point to make in our detailing of the financial deregulation ushered in by Reagan, and subsequently under Clinton, and the relevance it has to the core statement in this thesis, is that it has led to massive upward redistributions of income to the very wealthy at the expense of the masses, along with de-unionisation but also in and of itself. It also introduced periods of great economic and financial instability (eventually sharp economic decline in 2008) in which the masses have suffered greatly and the elite, those who caused such crises due to said-deregulation included, comparably not at all. In fact they have essentially remained invincible and beyond recourse.

Just as the process of neo liberal de unionisation came under the cover of being as part of the general war against inflation, the elite sought to impose radical deregulation of the financial sector in a new covert manner, related to another set of economic circumstances.

During the 1950’s home mortgage finance had come from a number of various financial institutions, yet by the 1960’s Savings and Loan institutions had become the main provider of residential mortgages, providing the market with nearly its full and overall level of mortgage demand. Ceiling Q regulations had existed on the amount of interest Savings and Loan institutions could pay on their deposits until the 1980’s. Therefore, during periods where monetary policy tightened i.e. when Fed base rates rose, money tended to move towards higher return and often more unregulated financial investments, such as government and corporate bonds etc. (Snider, 2011, p.1). Necessarily this led to a situation whereby Savings and Loan institutions, with reduced deposits could not supply as much credit to those seeking to borrow for home mortgages.

With the election of Reagan in 1980, during the early 1980's actions were taken by the Federal government to stop such a situation whereby supply side rationing occurred. The first of these actions was The Depository Institutions Deregulation and Control Act which eventually eliminated the Regulation Q settings imposed upon Savings and Loans Institutions, thus allowing these institutions to take on riskier behaviour and allowed more commercial banks to enter the mortgage market (Sneider, 2011, p. 2).

In 1981 the Federal Home Loan Bank Board created federally insured FHA mortgage loans (Sneider, 2011, p.2) While they were more expensive, they were federally insured and thus provided banks with more of an incentive towards reckless lending, knowing that should such loans turn wrong the government would always meet the bill. This further established the principle set in the New York City Financial Crisis that should the banks be faced with losses the masses were to cover the cost. The most directly dangerous economic effect of this though was that it essentially created the sub-prime mortgage market and thus directly increased the financial vulnerability of the same people whose wages were to be suppressed due to the on-going process of de-unionisation which was occurring under Reagan. This action had further ramifications for general financial practice as well for once this was approved for FHA loans other home loan providers began providing more of these higher loan-to-value ratio mortgages also (Sneider, 2011, p.2). As (Krugman, 2012, ch.4) notes this created a distinct contradiction between measures implemented within the Glass Steagall Act of 1933 protecting consumers deposits and those measures which limited the risk banks could take with these deposits. The FDIC (Federal Deposit Insurance Corporation) was established to guarantee the deposits of depositors should the bank they placed their deposits in fail. On the other hand, Glass-Steagall limited the amount of risk banks could take and this was thought necessary to avoid the moral (and intense economic hazard) of banks gambling with the insured deposits of their depositors. With the creation of FHA insured loans however, and the spread of risky mortgage practices to other financial institutions as a result of this action, this risk of avoiding defaults on depositors was removed as both deposits and the home loans being issued by the banks were insured by the Federal government against loss.

The move which most created an out of control financial/financial mutant system however, was the Garn-St Germain Depository Institutions Act. The act allowed for the authorization of money market deposit accounts with unregulated deposit rates. This fuelled the establishment of a secondary market where mortgages were bought and sold that allowed for Savings and Loan Institutions and banks generally to sell home loan mortgages first granted by them on to other financial institutions and so obviously encouraged further recklessness in their mortgage lending practices as they ultimately were not to have to be tied down to such loans (Sneider, 2011, p. 3).

The relevance of the financial deregulation that occurred during the 1980's under Reagan to the *–The End Of The U.S. Golden Age Of Capitalism–* is that financial deregulation, in conjunction with its neoliberal counterpart de-unionisation set the stage for a small elite to make vast sums of money while the incomes of the masses rose by only a fraction of theirs.

A study by the CBO (Congressional budget Office) details the growth in income between income strata's from the year 1979-2007, i.e. with the base year being the year just before Ronald Reagan assumed the presidency until just before the crash of 2008. The study found that the incomes of the bottom 20 percentile rose by a mere 18%, those in the middle percentile range rising by 32.5%, those in the 80th-99th percentile rising by an extremely healthy 65%. Yet the incomes of the top 1% (as made famous by the Occupy Wall Street Movement until its inevitable suppression) rose by a staggering 277.5%! (Krugman, 2012, p.29).

Arguments which state that the large increase in income inequality in the U.S. has come about due to differences in education amongst various income strata's, while somewhat true are largely debunked by Krugman. He states how the top 25 highest hedge fund managers in one year earned three times the salaries of all 80,000 New York City schoolteachers and goes on to say that if we consider schoolteachers to generally have third level education than we cannot say that it is education which has driven the expansion in income inequality (Krugman, 2012, p. 29).

Rather, from the example above and empirical evidence, it would seem that financial deregulation has been one of the main culprit of the divergence of incomes between the income strata in the U.S. In describing the housing boom that occurred as a result of the deregulation of the 1990's, (Weller and Sabatini, 2008, p. 608) state;

–Financial crises that result from such investments are preceded by a widening gap between financial market trends and real economic outcomes”

Further underlining the fact that deregulation of the U.S. financial industry has produced benefits vastly disproportionately for the wealthiest Americans is Weller and Sabatini's assertion that;

–The financial sector expansion was matched by slow real economic trends, especially meager or even negative real income growth, fuelling the asset and credit market expansion, but also making it unsustainable” (Weller and Sabatini, 2008, p. 609)

However, not all the blame for the deregulation that occurred (which as we have stated has contributed directly to U.S. inequality) may be laid to rest at the feet of Reagan. Further steps towards deregulation of the financial industry were taken under the administration of Bill Clinton.

On the 12th November 1999 President Bill Clinton signed the Gramm-Leach-Bliley Act into law. This new law repealed the Glass-Steagall Act and thereby ended the the separation of banking, insurance and securities operations (Federal Reserve Bank of Philadelphia, 1999, p.1). Whereas the financial deregulation passed made law by Reagan had in fact been an outright case of corporate charity, in line with the free market ideology of the Republican Party, the repeal of Glass Steagall had come as a result of intense campaigning and effective bullying of the Federal Government by the Wall Street. It was a sign of just how powerful the

American financial industry had by this stage become since the financial deregulation of the 1980's, the decade of American neo-liberalisms great birth.

Underlining the vastly increased power of banks to influence political decisions in relation to banking were the vastly increased sums of money they were now making as a result of the deregulation that had occurred under Reagan and the contributions towards political representatives campaigns they were now making as a result of this increased income. By 1993-1994 Financial Services PAC's (Political Action Groups) had become the largest single group of corporate contributors by dollar value, contributing just under 15% of the \$200 million donated by PAC's during the 1993-1994 congressional election cycle (Stratmann, 2002, p.349). Also, of the 182 legislators that ordered that a vote be held on the repeal of Glass Steagall in both 1991 and 1998, only five had not received contributions from the financial services sector between both votes (Stratmann, 2002, p.349).

As a result of the repeal of Glass Steagall U.S. wage inequality, driven by the power of those at the top to make large speculative gains as a result of extreme financial deregulation continued unabated.

Chapter 7

Effects Today

Perhaps the greatest, penultimate confirmation that all remnants of the U.S. "Golden Age of Capitalism" had been completely eradicated was the leaking of a 2005 secret memo by Citigroup to their clients.

The memo; *—Plutonomy : Buying Luxury, Explaining Global Imbalances*” is essentially an endorsement of the U.S.A. as an economy of massive concentration of wealth amongst the top echelons of society, and claims growth in these economies it deems as plutonomies is driven primarily by the very wealthy.

Its opening statement reads; *“The World is dividing into two blocs - the Plutonomy and the rest. The U.S., UK, and Canada are the key Plutonomies - economies powered by the wealthy. Continental Europe (ex-Italy) and Japan are in the egalitarian bloc”* (Kapur et al. 2005, p.1)

The memo states that; *—In a plutonium there is no such animal as —the U.S. consumer” or the —U.K. consumer” or indeed —the Russian consumer”.* *There are rich consumers, few in number but disproportionate in the gigantic slice of income and consumption they take. There are the rest, the —norrich”, the multitudous many, but only accounting for surprisingly small bites of the national pie”(Kapur et al. 2005, p.2)*

The report shows that the top 1% of U.S. households accounted for 20% of income in 2000, only slightly smaller than the share of income attributable to the bottom 60% of American households. It goes on to state that the top 1% of households also account for 33% of net worth, a figure greater than the net worth of the bottom 90% of households added together. Reflecting the fact that the top 1% of households are more likely in the extreme to earn

income from rent, interest or profit as well as wages (as opposed to purely wages) are that the top 1% of households account for 40% of *financial net worth*, more than the bottom 95% of households put together (Kapur et al. 2005, p. 3)

Particularly galling about this report is the very fact that it is written by Citibank, who were instrumental in seeing Glass Steagall repealed in 1999 when their holding company Citicorp wished to merge with Travellers Group, an investment firm (Krugman, 2012, ch.4). Therefore with this report we have a major financial institution describing the same U.S. income inequality that the financial deregulation by the Federal Government they directly campaigned for helped create!

The U.S. wage and general inequality that has come as a result of the neo-liberalist policies implemented by the U.S. political establishment since the 1980's is not purely an issue of economic equality i.e. maintaining everyone's fair stake within society. According to Joseph Stiglitz it is also acting as a major obstacle to recovery from the current slump the U.S. finds itself in today. Four reasons are provided by Stiglitz for this.

- (1) He states firstly that the middle classes are too weak to support the consumer spending that has historically driven U.S. economic growth. While the top 1% of income earners took home 93% of the growth in income in 2010, middle income households, generally considered the drivers of consumer demand, now had lower inflated adjusted incomes than they did in 1996. While the growth in the ten years preceding 2008 was in itself already unsustainable, as it was based on the bottom 80% of income earners spending 110% of their income.
- (2) Secondly, stagnant incomes for the middle classes have become prohibitive since the late 1970's leaving many middle class families unable to invest in themselves and their children by starting or improving businesses
- (3) Middle class weakness is holding back government revenues, while those at the top are paying so little tax due to tax avoidance, due to their apparent aptitude at paying little tax within the current system and in their ability to lobby Washington to make this situation so. Recent moves towards restoring Clinton era tax levels on individuals making over \$400,000 and households with household income will do little to improve the situation as returns from Wall Street speculation are taxed at far lower rates than other forms of income. All this, in Stiglitz's view leads to a situation whereby the Government lacks crucial revenue to make necessary investments in infrastructure and education, crucial for returning long term economic strength.
- (4) Finally, Stiglitz states how inequality is associated with more frequent and greater in magnitude boom and bust cycles. He states that; *“Though inequality did not directly cause the crisis, it is no coincidence that the 1920s — the last time inequality of income and wealth in the United States was so high — ended with the Great Crash and the Depression. The International Monetary Fund has noted the systematic relationship between economic instability and economic inequality, but American leaders haven't absorbed the lesson”* (Stiglitz, 2013, New York Times)

However, it is an issue of the very *economic vitality* of the nation also. In his highly insightful article “Wealth gap can't keep growing” David McWilliams states that the wealth gap must begin to lessen for;

–The re-emergence of the ordinary Joe is not just a political question; it is a question of economic survival, too. After all, where does corporate America think consumer demand comes from? It comes from the income of the average guy – and wages are his income”

(David McWilliams, 2013)

Chapter 8

Conclusion

In conclusion I have found in my thesis that the post war system was characterized by a strong degree of income equality whilst still maintain capitalist incentive to make profit and high levels of economic growth. Key to the economic system that underpinned this economic framework was the endorsement by the federal Government of Keynesian demand management and deficit spending in time of recession.

The system was made possible by a healthy balance between the power of both Unions and Employers i.e. the masses of workers and the Business owning community i.e. the Elite. The elite were happy with the share of wealth attributable to them during these 25 years i.e. from 1945-1970 but when their position was threatened during the 1970's due to the stagflationary recession of that decade, they began to fret and so administered and orchestrated an essential takeover of the reigns of U.S. federal government policy.

Since the 1980's with the election of Reagan and the general rightward shift of U.S. politics that occurred in that decade, the power of the elites has increased tremendously. Key to their increased power has been de-unionization and financial deregulation. Income inequality grew tremendously from then on, and as we may see from this thesis the elite within U.S. society may be considered to have been the drivers of Federal government policy over the last circa 30 years.

This process, which began in the 1980's under Reagan may essentially be considered as an essentially self-fulfilling prophecy whereby the elites have been awarded more and more power due to political pressure being applied and backed up with vast amounts of wealth. As more pro elite policies have been implemented in their favour i.e. financial deregulation, tax breaks etc. their financial power has increased only further, leading to more political power and more pro-elite policies.

This is confirmed by the fact that even after the savings and Loans Crisis of the late 1980's to early 1990's, and after the very same financial institutions had been bailed out by the tax payer to the tune of \$300 billion the federal Government then in 1999 awarded these very same interests with the repeal of the Glass Steagall Act.

In this thesis I believe I have established a highly plausible link between further powers being provided to elites in the U.S. and rapidly increasing levels of wage inequality from the 1980's onwards.

Finally, I go on to state the fact that U.S. wage inequality has now become so great that it is a threat to the U.S. economy itself and must be addressed for the nation to truly prosper.

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