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CHAPTER 9

AMERICA AS A RIGGED GAME

The Harder They Fall

T'S HARD TO BELIEVE now that in the year 2000 the United States was universally considered to be the first "hyperpower" in world history—a nation so wealthy and powerful that it had achieved global dominance without seeming even to try.

The United States was the richest and fastest growing of the major industrialized nations, with the most advanced technology base and an utterly dominant military. The Internet industry, the source of the most profound technological and industrial revolution of the century, was completely dominated by America. With the former Soviet Union in collapse and China converted to government-led capitalism, there would even be a "peace dividend." Even during the Asian financial crisis of the late 1990s, American growth continued and the unemployment rate stayed below 5 percent. America could do no wrong.

But the fall of the mighty is a classic theme of tragedy. And few na-
tions have fallen as far and as suddenly in the world’s eyes as the United States since the beginning of the new millennium. How could this happen? Superficially, it seemed to come from nowhere; but in reality, America’s descent has been in the making for decades.

One common interpretation, particularly among progressives and Democrats, is that the Bush administration did it. According to this view, a superbly managed Democratic administration (Clinton’s) bequeathed a broad prosperity to George W. Bush, who squandered it on wars and tax cuts while letting the banks run wild. Then the Bush administration left the mess to Obama, who is struggling to pick up the pieces and get the economy back on track, a task made even more difficult by the intransigence of Republicans in Congress.

There is some truth to this story. The George W. Bush administration was certainly in a class by itself. First, Bush devastated America’s finances with his incompetently managed wars and enormous tax cuts. The tax cuts, which heavily favored the very wealthy, were enacted even as military spending rose in the wake of 9/11 and the invasion of Afghanistan, and even though federal tax revenues had plummeted with the collapse of the dot-com bubble. Then came the almost unbelievably incompetent, unplanned, politicized occupation of Iraq, which turned a three-week war into a $2 trillion, ten-year quagmire, at a time when the United States already had its hands full with Afghanistan. And, of course, the Bush administration’s coup de grâce was the outrageous, frequently criminal financial bubble that brought us to the edge of the abyss in 2008 and left the American (and world) economy damaged for years to come.

So, yes, there was unquestionably enormous hubris, greed, stupidity, and dishonesty in the George W. Bush administration. But, tempting as it may be, blaming everything on the Bush administration is deeply wrong, and it misses the main point.

Because the main point is this: over the last thirty years, under Democrats as well as Republicans, the United States’ political-economic system has lost its way. There have been occasional episodes of real progress such as the Internet revolution; and in some areas, such
as theoretical computer science and entrepreneurial high technology, America remains unmatched. But the dominant underlying trend has been, and remains, severely negative. America has quietly become a profoundly different place, with its economic competitiveness, its basic fairness, the education of its population, and its politics all in sharp decline.

Economic power in America has become far more concentrated, both structurally and individually. Structurally, several of America's largest industries and the American economy as a whole have become far more concentrated since deregulation began. We have already seen this with regard to financial services. But the same thing has happened in energy (the four largest oil companies), telecommunications (AT&T, Verizon, the cable industry), the media (which overlaps with the cable and entertainment industries), retailing (Walmart, Amazon, etc.), agribusiness and food (McDonald's, Yum Brands), and other industries, even information technology.

In part this trend toward consolidation has been caused by the Internet and information technology, which allow the efficient management of much larger organizations covering wider markets and geographical areas. But in large part, this trend has been the result of corruption—corporate money that neutered antitrust policy, the political system, and the economics discipline. In many industries that have sharply consolidated or have been concentrated for a long time—including financial services, automobiles, telecommunications, and the media—there is absolutely no reason to believe that higher concentration brings higher efficiency.

In fact, the evidence points in exactly the opposite direction. Many of the most successful foreign industries that have overtaken America's—cars, telecommunications, and consumer electronics, among others—were less concentrated than America's. If GM had been broken up long ago, forming two or three firms that really had to compete, the American car industry would almost certainly be in better condition. Unquestionably, such concentrated power also contributes to income inequality. Large firms in concentrated industries have much
more bargaining power relative to employees and suppliers. Walmart, McDonald’s, and other huge firms are famous for being brutally tough on their suppliers, forcing them to cut costs, and also for their opposition to unionization of their enormous, low-wage, retail workforces, who often have very difficult working conditions.

Nonetheless, the structural concentration of American industry has continued over the last thirty years. At the same time, economic power in America also became more concentrated at the individual level, with a small number of households owning the majority of America's financial wealth and providing a high fraction of individual political campaign contributions:

The combined result is that the United States is increasingly controlled by an amoral oligarchy that has progressively corrupted the federal government and the political system, including both political parties. This political corruption has in turn further entrenched the wealthy and the financial sector, and has now become a major driver of America’s economic and social decline.

The wealthy are safe from the effects of this decline, at least for now; indeed, they have benefited from it, because they have skills, financial assets, mobility, and political power. They are also increasingly insulated by parallel, private systems for education, security, infrastructure, and financial services. The absence of significant political or social protest in response to these changes, Occupy Wall Street notwithstanding, has emboldened them to continue. At the same time, and in part as a result of these changes, the bottom two-thirds of the American population has become less educated, less informed, less prosperous, angrier, and ever more cynical about its political leadership. There is good reason for this cynicism. In their stomachs, most Americans know that their leaders are lying to them and that the system is rigged. America is still a wonderful place for thirty or forty million people. But for the bottom hundred million or more, not so nice.

When America started its economic decline in the 1970s, Americans’ first responses were simply to work longer hours and go into debt. But after a confused, failed reform attempt by Jimmy Carter, American
politics turned increasingly to demagoguery and corruption. The political system’s response, particularly among Republicans, was to pretend that the problem was taxes and excessive government, while hypocritically using deficit spending and financial bubbles to cover up America’s long-term problems. Democrats made vaguely progressive noises but did little about them, while giving ever more to the financial sector and the wealthy. But those options are wearing thin and will eventually be exhausted. Unless America reverses course, things will end badly, at least for the bottom 90 percent of the population, and possibly even for the wealthy who consider themselves safe.

For most of American history, the American people have responded well to challenges, including dangerous or corrupt leadership. But this is the first time that America has faced a combination of structural political corruption, rising inequality, and long-term economic decline. Ahd so far, American politics has mostly been producing decisions that make things worse, not better—and are economically and politically unsustainable.

America is entering a dangerous zone. On the one hand, excessive concentration of power tends to produce an echo chamber, in which those at the top only need to deal with each other. There is less pluralism, less competition, a narrower range of options and views, less room for maneuvering. Companies have more power, because there is less choice; it’s harder for employees, suppliers, and customers to talk back to them, or threaten to switch. This isn’t healthy.

But in addition, America’s economic decline will inevitably produce increasing social pressures. Economic and social insecurity can produce activism for reform, but they can also produce anger, desperation, and dangerously simple solutions. They encourage nasty charlatans to distract public opinion from America’s real challenges in favor of stupid, extremist, counterproductive measures—or simply doing nothing.

America’s deterioration is now systemic and structural, and it is causing the unthinkable to become possible in the United States, just as this is already occurring in Europe. Until the global financial crisis, the “great recession,” and the European sovereign debt crisis, nobody
would have believed that Europe faced a serious risk of financial crisis, possibly accompanied by major social and political instability. But now it is clear that Europe does face these problems. And not so long from now, America could too.

For reasons explored below, the American national system—the combination of educational and economic opportunity, farsighted government policy, freedom of debate through an independent press, an academic system that provided critical analysis of self-interested arguments, and two-party political competition that kept America prosperous and dynamic for many decades—has come undone. This has destabilized, and yet paradoxically also frozen, American politics; when you look below the surface, since about 1980 there has been a frightening continuity in political behavior. With each decade, federal policy under both political parties has tilted ever more toward the financial sector, the very wealthy, and the most powerful, most concentrated, and frequently most inefficient or damaging industries in the United States.

There is also, undeniably, a cultural dimension to this. The American people have become increasingly scared, frustrated, angry, cynical. Some demand reform, but many others want a return to a simpler, more secure, more traditional time. They are susceptible to extremist politics and religion, and to fake promises of easy prosperity, whether coming from preachers, politicians, or bankers. Many others have just given up, not bothering to vote or pay attention to politics at all. In this environment it has proven all too easy for politicians, who are so easily hired by America's new oligarchy, to exploit popular anger and fatigue while actually delivering oligarchic policy. Newt Gingrich attacks government after being paid $1.6 million to lobby for Freddie Mac; Mitt Romney pretends that the financial crisis was caused by excessive regulation; and their archenemy, President Obama, promises reform while protecting Wall Street.

On balance, the Republican Party has produced the worst, most flagrant behavior, but this has become a thoroughly bipartisan process. In fact, some of the most destructive policies leading to the financial
crisis were initiated by the Clinton administration, not by George W. Bush, and some of Bush’s most destructive policies were supported by many congressional Democrats. More recently, Barack Obama has chosen both personnel and policies stunningly close to both the Clinton and Bush administrations, and in some ways even worse. Obama has brushed the mud off the same dishonest and discredited people, kept the financial sector’s privileges and incomes intact, avoided prosecution of financial crime, and done almost nothing about the foreclosure crisis and the millions of Americans who owe more on their homes than they are worth. (As of 2012, about 20 percent of American mortgages were still “underwater.”)

Perhaps worst of all, the Obama administration has done nothing to address the long-term decline of the United States. It has said little, and done less, about America’s growing inequalities of income and wealth, the deterioration of public education and educational opportunity, the predatory criminality of the financial sector, or the many ways that money now corrupts American economic policy. As soon as he took office, Obama quietly dropped his reformist, activist campaign rhetoric in favor of claims that recovery was under way and all would be well. As the 2012 election approached, he started to move back toward the reformist rhetoric, but without actually doing anything.

In short, when it comes to the central issues facing the American economy, both parties are moving in the wrong direction. The noisy arguments that dominate the headlines are sideshows. On the critical questions, America’s new rulers are calling the tune. What is going on here?

In May 2009 Simon Johnson, an MIT professor and former chief economist of the IMF, published a powerful article in the Atlantic Monthly entitled “The Quiet Coup.” Johnson catalogued the uncontrolled growth of America’s financial sector and its toxic consequences, warning that the United States was starting to look dangerously like an emerging market oligarchy (or to say it less pleasantly, a banana republic, a third-world dictatorship), complete with sovereign debt problems, financial crises, bailouts of the rich whenever they mess up, and caste-
like divisions between rich and poor. Johnson pointed out that often this process ends with the oligarchy overreaching itself so severely that financial crisis leads to depression, which in turns leads to political revolution. For America to avoid this fate, Johnson argues, it must break up its largest banks and reassert control over the financial services industry.

My own view is that in one way things are more hopeful than Johnson suggests, while in others he actually underestimated America's problems, because they go beyond the financial services industry.

On the hopeful side, I believe that America is still a sufficiently open and democratic society, however imperfectly so, that when the American people finally decide they have had enough, change will be possible. The numbers—at least the numbers of people—are on the side of reform. It isn't even really the financial industry that is on the other side; it's the financial sector's elite, the fifty thousand people who make the serious money and control the companies. This is not an insurmountable opposition. And, several times in the last half century, America has seen citizens' movements that successfully brought about major political change from below, even when both political parties initially paid no attention. The civil rights, women's rights, and environmental movements come to mind. Popular anger can even remove a president and his entire administration, as we saw with Richard Nixon and his cronies after Watergate. I think the major reason that money-driven politics has succeeded for the past several decades is simply that most of the American people are not yet angry enough, not yet aware of just how badly they have been taken. Many others are too cynical to use the established system but not angry enough to make the system change.

On the other hand, America faces two problems beyond those Johnson mentions, and which complicate reform efforts. First, as I will describe in more detail below, America's political parties and governmental machinery have been hijacked in a very clever, powerful way that defies easy remedies. In 2010 I coined the term "political duopoly" to describe this situation, in which the two political parties agree to disagree violently on social issues while both serving America's economic
oligarchy and blocking the rise of third parties and reform efforts.\textsuperscript{1} Economic decline and America's new oligarchy are therefore more resistant to popular activism than was (and is) the case with regard to, say, discrimination against women or environmental pollution.

And second, America's problems go beyond any one industry. While the financial sector has unquestionably become America's most powerful and dangerous industry, it isn't alone. For much of its deregulatory agenda, the financial sector has important allies, particularly in the telecommunications, energy, media, health care, and industrial agribusiness/food industries, as well as several thousand ultrawealthy families. These people share the financial sector's desire to translate their wealth and cohesion into political power in order to shelter themselves, their families, their personal assets, and their industries from competition, prosecution, effective regulation, proper corporate governance, and taxes. They can even count on substantial support from people who run honest businesses but who still benefit from lower taxes and less regulation.

But this situation is not merely unfair; it is economically disastrous. The least-discussed but perhaps most important effect of money-based politics is that it has caused government policy to shield incompetent and/or predatory industries from internal reform and competitive discipline. This problem goes far beyond finance, and is critical to understanding not only the financial crisis but also America's broader economic decline.

General Motors and Chrysler didn't go bankrupt just because of the financial crisis in 2008; they went bankrupt because for decades previously, they had been in unchecked managerial decline. They were run by incompetent, lazy, insular, selfish managers, with no interference from their complacent boards of directors or the antitrust authorities—and, indeed, with the frequent \textit{assistance} of U.S. government policy. They should have been broken up or forced to reform their corporate governance long ago. But they weren't, and we all paid for it—literally. The same was true earlier of other American industries, such as steel and consumer electronics, that failed so completely that they have largely
disappeared from the American economy. As we shall see shortly, the same is now true of telecommunications. America’s telecommunications oligopoly is retarding progress in broadband infrastructure, an extremely dangerous situation given the role that Internet services now play in economic performance. So although the financial sector is the most obviously dangerous part of America’s new oligarchy, it is not the only one contributing to American decline.

In the remainder of this book, I shall examine first the causes, and then the implications, of America’s political-economic decline. Then I will describe the emergence of America’s political duopoly—the system by which both the Democratic and Republican parties are now dominated by America’s new oligarchy, and how the parties handle this situation strategically. I will examine the consequences of this situation, including the Obama administration’s personnel and policies. I will then consider the current and future determinants of American competitiveness, using broadband communications, Internet services, and information-technology hardware as examples. Finally, I will offer some ideas about what the future holds, what the most critical goals for reform are, and whether America can pull itself out of this morass.

I will begin by examining the beginnings of American industrial decline in the 1970s, and how America’s major industries responded to this decline. Faced with growing challenges, America’s business elites found a cheap way out—one that has turned into America’s biggest problem.

**Explaining Decline: The Destabilization of the American National System Since the 1970s**

Why do we see, over and over, the cyclical rise and fall of companies, national industries, nations? The British Empire, General Motors, U.S. Steel, Microsoft, the United States—we see the same pattern over and over again. An initially small, powerless company or nation devises a superior way to run itself; it becomes enormously successful,
vanquishing all rivals; but then, at the height of its apparent power, it begins to decay from within. It starts to coast. It becomes lazy, politicized, complacent, dysfunctional, corrupt; and eventually, after a period of internal decay, it collapses under its own weight or falls prey to some aggressive new competitor.

The United States has now entered such a systemic decline, and the rise of America's economic oligarchy and money-based political system is both a cause and a symptom of it. As is typical in such situations, the decline of the United States' political and economic systems began at the height of American national power. Money-based politics was not the initial cause of American decline, but it was the way that America's largest industries responded when they were threatened. It turned out to be easier and more effective (more effective for them, not for the country) to pay people off than to undertake real, painful, internal reform.

The initial source of American decline was the complacency of American industry, permitted by the concentration and global dominance of what then constituted the core of the U.S. (and world) economy. In part because World War II had devastated most potential competitors, and in part due to the enormous size of the U.S. domestic market, American industry faced no serious competition, either foreign or domestic, for a quarter century after the war. During this time, America's largest and most important industries gradually became complacent, rigid, highly inefficient oligopolies or even in some cases monopolies. They also came to have complacent, low-quality corporate governance and, in some cases, unions that contributed to systemic rigidity. They were not attuned either to innovation or to competitive threats, either domestic or foreign. Many senior managers also deliberately resisted innovations that would have rendered their skills obsolete, and would have reduced their internal power and status.

The industries displaying this pattern in the 1970s and 1980s included automobiles, steel, telecommunications, mainframe computers, minicomputers, photocopiers, cameras and film, semiconductors, and consumer electronics. Together they formed the core of the U.S.
economy. They accounted for a major fraction of GNP, and they were among the wealthiest, most powerful industries in the United States and in the world. They dominated U.S. and often world markets, and were either regulated monopolies, oligopolies, or industries dominated by a single firm whose competitors lived in its shadow.

In the automobile industry, the Big Three (GM, Ford, Chrysler) dominated the U.S. market and held roughly half the total global market. An oligopoly of a half dozen integrated steel companies, led by U.S. Steel, similarly dominated the domestic steel market. IBM held about two-thirds of the total global computer market, with smaller mainframe producers (the so-called “Seven Dwarfs”) and a half dozen minicomputer producers holding most of the rest. AT&T was a regulated monopoly that controlled over 90 percent of all U.S. telephone and data services. Kodak dominated the film and camera industries; Xerox held a patent monopoly on photocopying for many years.

The growing inefficiencies of these industries also affected their suppliers and customers. The stagnation of the U.S. automobile industry contributed significantly to the decline of automobile parts suppliers and of the machine tool industry. By the late 1980s, Japan had definitively surpassed the United States not only in the automobile industry but also in machine tools and robotics, as well as in their advanced use in a variety of manufacturing sectors. Similarly, Japanese excellence in producing commodity semiconductors and liquid crystal displays pulled along its semiconductor capital equipment industry.

America's largest industries had always wielded political influence, but for the first quarter century of the postwar period they did not wield it very aggressively, because they did not need to. They were naturally successful and profitable, with an almost leisurely dominance of both their domestic and international markets. Because their industries were mature, entry into their markets by small start-ups was for the most part impossible due to scale, capital requirements, and systems effects. In some cases, such as telecommunications, the media, and parts of financial services, new competition was legally limited or even prohibited. In a few cases (AT&T, IBM), antitrust actions were un-
dertaken to limit the incumbents' power. But for the most part American industry and the federal government left each other to their own devices for the three decades following the Second World War.

Over time, however, oligopoly and lack of competition led to complacency, which in turn led to inefficiency. By the 1980s, these inefficiencies were so severe that the productivity and product price-performance ratio delivered by the dominant firms in major U.S. industries came to lag best practice by enormous margins—factors of two or more in productivity for traditional manufacturing industries, and up to an order of magnitude in the price-performance ratio of high-technology products such as computers.

One of the most striking demonstrations of this occurred in Fremont, California. General Motors opened an assembly plant there in 1962 and then closed it as unprofitable in 1982, in part because the UAW-unionized workforce was regarded as unmanageable. By this time GM's inefficiency was obvious, and it was facing intense competition from the Japanese. Under enormous political pressure from the U.S. government, in 1984 Toyota agreed to form a joint venture with GM and to reopen the Fremont plant under Toyota management. The unstated but clear intent was to force Toyota to save GM from itself by teaching GM how to use Toyota's "just-in-time" or "lean" production system. The result was a stunning indictment of GM. Using the same unionized workforce that GM had written off as hopeless, Toyota rapidly doubled productivity and sharply increased the quality of the cars that Fremont produced. But despite Toyota-organized tours of the plant for GM managers and videotaping of plant activities, the rest of GM learned very, very slowly.

This was not an isolated situation. Careful studies conducted by MIT and Harvard in the 1980s and 1990s demonstrated that Japanese car companies were approximately twice as productive as their American (and some European) competitors in both design and manufacturing. Similar results were found when American integrated steel firms were compared with the Japanese industry and American start-up "minimills." Even stronger results were found when comparing Ameri-
can to Japanese manufacturers in their use of robots and computerized flexible manufacturing systems (FMSs).³

By the early 1990s, an even more remarkable situation held within the U.S. computer industry. The price-performance ratios of microprocessor-based personal computers, workstations, and servers were twenty to fifty times superior to those of the mainframe computers and minicomputers that constituted the core business of IBM, the Seven Dwarfs, and most of the minicomputer industry. But in the case of the computer industry, the vastly superior challengers were predominantly American. The U.S. venture capital industry and Silicon Valley are superb at creating new start-ups, and entry costs for companies based on new information technologies are generally relatively low. In those cases, the U.S. system largely self-corrected through domestic start-up entry. IBM deteriorated and most of the others went out of business. But in their place we got Intel, Microsoft, Compaq, Dell, and Apple. Alone among the earlier generation of firms, IBM was able to reform itself, after falling into a deep crisis in the early 1990s.

But IBM was an exception; most of America’s declining giants failed to reform themselves. And in more mature sectors such as automobiles, steel, machine tools, photographic film, and photocopiers, start-up entry was and is impractical. To create a new competitor would require a gigantic, lengthy commitment. And the U.S. financial and industrial system, unlike those of Japan, South Korea, and China, is not good at creating new companies in mature industries that require large initial capital investments.

In contrast, the Japanese (and later, South Korean and Chinese) did finance new entry into these industries. This was because the Japanese business sector was dominated by six diversified, vertically integrated financial-industrial complexes (keiretsu) that could create new companies even in mature industries. Japanese industry also engaged in large-scale technology licensing, copying, and intellectual property theft, aided by Japanese industrial policy. South Korea had a similar system (based on the chaebol). In China the central government, the People’s Liberation Army, provincial governments, and state-owned
enterprises are now playing a similar role in technology extraction, financing of new domestic entry, and protection of the domestic market from uncontrolled foreign competition.

The comparative ability of different national economic systems to generate new competition in large, mature industries is a subject that the economics discipline has mostly ignored. But the inability of the U.S. national system to create major new competitors in mature industries is extremely important, because it means that the United States faces a very limited set of options when large companies and concentrated industries go into decline. If start-up entry is feasible, as in most IT and Internet markets, U.S. industry renews itself and remains healthy. But if start-up entry is not feasible, then there are only three possibilities. They are:

- The U.S. government acts to restore competition and/or reform corporate governance; for example, through antitrust action that breaks up the largest firms.
- Foreign competitors take over, with some resultant loss of U.S. economic welfare.
- If no foreign competition appears, the U.S. industry goes into uncontested decline, imposing the costs of its inefficiency on the American economy and population.

The result has usually been some combination of the second and third options. Since the 1970s, in case after case—GM, Chrysler, most mainframe and minicomputer companies, major steel companies, nearly the entire consumer electronics industry—the failure to adjust has eventually led to wrenching crises, downsizings, bankruptcies, or acquisitions at fire-sale prices. Whether the challengers were foreign or domestic, the incumbents generally resisted change as long as they could, often through political activities, and consequently suffered even more severely when reality could no longer be denied. In many cases, including automobiles, steel, and telecommunications, incumbents were able to retard both competition and reform sufficiently
that they imposed major costs on the American economy. And now, to those costs we must add the impressive damage caused by powerful predatory industries—especially financial services.

Indeed, seen in the context of broader American industrial decline, the financial services industry is not entirely exceptional. While much of the damage it caused was rationally, morally predatory, some of it came from the same kind of managerial decadence that ran GM and Chrysler into the ground. Jimmy Cayne, Stan O'Neal, Chuck Prince, Richard Fuld—these were people way above their rightful pay grade, kept there by oblivious, complacent boards of directors, just the way things worked at GM, Chrysler, U.S. Steel, Kodak, and IBM before 1993. The principal difference was that finance can be really dangerous. In contrast to the automobile industry, people in finance were able not only to loot their companies but also to bring the global financial system to its knees.

The rise of China, India, and other Asian nations had another effect on the calculation of American industrial executives, of course. It provided a gigantic new pool of extremely low-cost labor to American firms. This meant that even a very efficiently run American company (in fact, perhaps especially a well-run company) no longer needed, or even wanted, high-cost American workers for many low-skill jobs, ranging from manual labor in manufacturing to call center personnel used in routine customer service. Outsourcing and offshoring were much more effective.

This meant that the United States could only remain economically healthy, and provide high-wage employment, if it radically improved the education and skills of its population, as well as its attractiveness as a location for high-technology activities. In fact, the reverse has occurred: America’s high school dropout rate is actually increasing, and American infrastructure, particularly broadband deployment, is falling ever further behind world standards. As a result, manufacturing in the United States has all but disappeared; it now accounts for 12 percent of GDP. High-skill custom manufacturing (such as for machine tools) is dominated by Japan and Germany, while labor-intensive
mass manufacturing is dominated by China, Vietnam, Bangladesh, and other low-wage nations. This has rendered an enormous number of American workers all but unemployable, except in minimum-wage service occupations.

But how and why was all this permitted to occur? It's complicated, of course. But a very big part of the answer is that an effective response to internal industrial decline and foreign challengers required major changes in American government as well as industry. It required major improvements in the educational system, aggressive pressure to force incompetent industries to reform, deployment of advanced broadband infrastructure, and a variety of regulatory changes.

But those measures had no focused, powerful, well-financed interest group to lobby for them. There is no wealthy, powerful industry that has an urgent, immediate need to improve the education and skill levels of the bottom half of the American population. In contrast, there were many other things that powerful, well-financed groups did want, and started to lobby for. When faced with internal decline and foreign competition, the executives in charge of large, concentrated American industries decided to start using money to get what they wanted. But only what they wanted, individually—not what the country as a whole needed. Indeed, what was good for their company's profits was quite often bad for the nation. If the CEO and senior management were lazy, outdated, and incompetent, then they wanted protection from antitrust policy, proper corporate governance, and competition. If the company and its industry were run by competent but predatory management, then additional lobbying goals might include evisceration of regulatory oversight and white-collar law enforcement.

And once they started down this path, executives in incompetent American companies discovered that corruption was a brilliantly easy, effective way to forestall, or at least delay, their personal day of reckoning. Later, their highly predatory friends in financial services realized that the same techniques would enable them to rape the entire country, even the entire world. And the rest of us have been paying for it ever since.
American Economic Decline and the Rise of Money-Based Politics

LET'S BEGIN WITH a case study: broadband infrastructure.

As noted above, the United States has fallen far behind other nations in broadband deployment. Broadband service in much of Asia, and even parts of Europe, is now vastly superior to U.S. services in speed, cost, and universality. To cite just one example among many, as of early 2012, 60-megabit per second Internet access was available in Taiwan for $30 per month, and by the time this book is published in mid-2012, 100-megabit per second service will be available for the same price. Japan, South Korea, Singapore, and even portions of mainland China now have far better broadband service than most of the United States. America, home of Silicon Valley and inventor of the Internet, does not have universal broadband access, for either landlines or Wi-Fi, and its services are slow, unreliable, and expensive. This situation has now existed for over a decade, and America's lag relative to Asia and Scandinavia is if anything worsening.

Why?

The reason is that both the traditional telecommunications and cable TV industries are tight, powerful oligopolies deeply threatened by high-speed Internet services. They view as particularly dangerous a nationwide infrastructure of universal high-speed Internet service combining both wireline and Wi-Fi access. This would sharply reduce the cost of data services; it would also enable universal, inexpensive Internet telephony and streaming Internet video that would render traditional telephone service, cable TV, and broadcast television totally obsolete. In the case of AT&T and Verizon, this would destroy the majority of their current revenues. In the case of the cable TV companies, advanced Internet infrastructure would also threaten them by allowing new competition in video content production and distribution.

While there exists some real competition between AT&T, Verizon, the cable industry, and smaller competitors such as Sprint and T-Mobile, the competition is very limited. After the breakup of the AT&T monop-
oly in the 1980s, there were about a dozen major telecommunications companies in the United States. There are now two; instead of competing with each other, they merged. They are still trying to consolidate further. AT&T recently tried to acquire T-Mobile; the acquisition was blocked by the Justice Department, the one and only time in the last decade that DOJ has halted the industry’s consolidation, which is still continuing. In late 2011 Verizon signed a major deal with America’s three largest cable companies, allowing them to cross-market each other’s services.\(^5\)

Despite very rapid progress (50 to 100 percent per year) in underlying digital technologies (routers, fiber-optic cable, software, digital wireless systems), the industry exhibits very low rates of improvement in its price-performance ratios. The United States now lags behind Scandinavia, Japan, and South Korea by a factor of ten or more.

The reason is money and politics. Lobbying is this industry’s real core competence. It spends more on lobbying, political contributions, and other political activities than it does on R&D. For example, the incumbents have successfully lobbied for state laws prohibiting municipalities from constructing their own fiber-optic networks, and they are probably the largest industrial users of antitrust “consulting” from academic economists.

A decade ago, my last project while a senior fellow at Brookings was to write a book about this issue. As a condition of publishing the book, Brookings censored my manuscript in exactly one place: the passage in which I had named the academic economists who had consulted for the telecommunications incumbents—including Brookings’s own Robert Crandall, as well as Laura Tyson, Peter Temin, Daniel Rubinfeld, Rich Gilbert, Jerry Hausman, Carl Shapiro, and the Law and Economics Consulting Group.

The industry’s political connections are superb. Laura Tyson isn’t just on the board of Morgan Stanley; she’s on the board of AT&T, too. In May 2011 Meredith Baker resigned as one of the five members of the Federal Communications Commission to become the chief lobbyist for NBC-Universal, four months after voting to approve its merger with Comcast. Verizon’s board includes a former chief accountant of the SEC, a former secretary of transportation, and a former treasury
secretary. And Bill Daley, who replaced Rahm Emanuel as chief of staff in the Obama administration from 2011 to 2012, was formerly the president of SBC, one of the regional Bell companies acquired by AT&T. The political situation is further worsened by the fact that the industry’s union, the Communications Workers of America, has consistently sided with the incumbents in opposing antitrust actions and other measures to improve competition and technical progress.

As a result, the total cost of using Internet services, smartphones, tablets, and personal computers in the United States is dominated not by hardware or software costs, but by the high cost of data services. The economic consequences of this situation are enormous. In economic policy debates, nearly all discussion of “infrastructure” concentrates on modernizing highways, airports, bridges, sewage systems, electric power, and the like. Those things are important too. But the future economic welfare of the United States depends more heavily on competitive broadband infrastructure. Education and Internet technology are the two principal drivers of productivity growth in advanced economies. Improved broadband services could also play a major role in reducing U.S. greenhouse emissions and dependence on fossil fuels through telecommuting, videoconferencing, and intelligent energy management systems. Moreover, universal broadband deployment would be an enormous physical construction project, an ideal stimulus for the U.S. economy in its weakened state. And finally, competitive broadband services are important to both the quality and the affordability of distance (online) education.

In other words, the United States is now paying a very high price for the rise of money-based politics. It’s not just unethical, it’s economically disastrous; and it’s not just in financial services.

Money, Politics, and Economic Performance

BEGINNING IN THE late 1970s, America’s major industries discovered, and began to exploit, a critical weakness in the American national system, one that enabled them to escape or at least soften competitive dis-
cipline. Stated bluntly, they discovered that buying people off was much easier than doing their job properly. It turned out that American politicians, academics, regulators, auditors, and political parties were highly corruptible. Their governance systems had been designed for an earlier age, and were not equipped to withstand serious efforts to corrupt them.

So, beginning in the 1980s, the senior management of America's declining incumbents became ever more aggressive in paying off their boards of directors, placing former government officials on those same boards, hiring former politicians as lobbyists, contributing to political campaigns, hiring academic experts to testify in antitrust cases, and so on. They merged with each other, sent production offshore, and cut the wages and benefits of their employees. They sought and obtained weaker antitrust enforcement, exemptions from environmental regulations, tax breaks, favorable accounting standards, protection from foreign competition via domestic content requirements. For example, despite the fact that U.S. corporate earnings reached a historical record of over 14 percent of GDP in 2011, federal corporate tax receipts were near historical lows, at less than 1.5 percent of GDP.\textsuperscript{6} American companies also resisted attempts to strengthen corporate governance. They kept public sector salaries low, thereby increasing their ability to subvert policy through revolving-door hiring. They weakened regulations, enforcement, and penalties for violations, and virtually eliminated any risk of criminal prosecution.

And to accomplish all this, since the beginning of this process several decades ago, America's largest businesses, banks, and wealthy individuals have sent money into American politics in a completely unprecedented way, first in rivers, then floods, and now in oceans. The money came in several forms: political contributions; lobbying; employment, through the revolving door; sometimes, outright bribery; and, often, access and connections for many purposes, ranging from private schools to personal loans to great parties to rides on private jets.

And the money is often nonpartisan, bipartisan, or to use a recent term, post-partisan. Many wealthy individuals now give simultaneously to both parties, and to incumbents regardless of their party. Goldman Sachs has a deliberate policy of maintaining equal numbers of Democrats
and Republicans in top management, including one of each at the very top. Companies choose lobbyists and board members from among former government officials of both parties in roughly equal numbers. Democrats now receive nearly as much money from business as Republicans do, although some industries, such as oil, still heavily favor the Republicans.

Here are some numbers.

In 1974 total campaign expenditures by all Senate candidates were $28.4 million. In 2010, they were $568 million. For the House of Representatives, total campaign spending in 1974 was $44 million; in 2010, it was $929 million. The presidency has become even more expensive. Campaign expenditures since 1976 are shown in Table 4 below:

<table>
<thead>
<tr>
<th>YEAR</th>
<th>TOTAL ($MILLIONS)</th>
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<tbody>
<tr>
<td>2008</td>
<td>1,324.7</td>
</tr>
<tr>
<td>2004</td>
<td>717.9</td>
</tr>
<tr>
<td>2000</td>
<td>343.1</td>
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<tr>
<td>1996</td>
<td>239.9</td>
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<tr>
<td>1992</td>
<td>192.2</td>
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<tr>
<td>1988</td>
<td>210.7</td>
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<tr>
<td>1984</td>
<td>103.6</td>
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<tr>
<td>1980</td>
<td>92.3</td>
</tr>
<tr>
<td>1976</td>
<td>66.9</td>
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</tbody>
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Furthermore, the sources of the money changed. The rise of money-based politics coincided with rising income inequality, and the two have reinforced each other. Political campaign donations have become highly
concentrated. By 2010 approximately 1 percent of 1 percent of the American population—fewer than twenty-seven thousand people—accounted for 24 percent of all campaign donations, totaling $774 million.⁸

The increase in campaign spending is starting to produce another dangerous effect: weakening media oversight of political dishonesty. Thankfully, America still has a very robust and independent free press. But the media industry, especially television and print, has been under increasing financial pressure as a result of the shift of both audiences and advertising to the Internet. In this period, there has been one sector whose advertising in the traditional media has continued to grow very sharply: politics. In presidential election years, the combined advertising expenditures of federal, state, and local campaigns, including PACs and so-called super PACs, probably now exceeds $5 billion. As financial services and other large industries have become more concentrated, the advertising spending of individual firms has also grown larger. The combined effect of higher political advertising and more concentrated corporate advertising has begun to generate pressure on major publications and news programs.

Lobbying has escalated similarly. Here are lobbying expenditures by the finance, insurance, and real estate industries from 1998 through 2010:

![Annual Lobbying on Finance/Insurance/Real Estate](image-url)
The personal financial positions of politicians, government officials, and regulators are equally important. Hence the spectacular growth of lobbying expenditures and incomes has a very real utility beyond the job that lobbyists do. Indeed, the lobbying industry's largest effect on policy probably isn't that lobbyists really convince anyone of anything. On the contrary, its principal impact derives from the simple fact of its existence, meaning that all senior public officials—whether elected, appointed, or civil servants—now know that if they behave properly, they can land a lobbying job when they leave government. And if they do, they will immediately quintuple their salary simply by moving to the other side. Here, the growth in income inequality, and in the differential between private and public sector salaries, has further worsened America's political corruption. In some nations, such as Singapore, senior civil servants and regulators earn competitive salaries, sometimes upward of $1 million a year. Not in America.

Here are some statistics on the salaries of public officials and their approximate private counterparts.

The Bureau of Labor Statistics compiles information on average federal government and private sector salaries for "employees in the securities, commodity contracts, and investments sectors in the United States (NIACS 523)." In 1990 the average federal employee in these professions earned $32,437, while the average private sector employee earned $61,047; so private sector employees earned 88 percent more than federal employees. By 2010, however, the average federal employee earned $45,462, whereas the average private sector employee now earned $196,339; so private sector employees made 331 percent more than federal employees. The same was true of other senior federal employees, including those most desirable as lobbyists. For example, in 2010, the average chief of staff for a member of the House of Representatives made less than $140,000; the average legislative director for a House member made less than $90,000. For further comparison, in 2010, federal cabinet members made $199,700, and the chairpersons of the SEC, the FTC, and the CFTC made $165,300.9

But these numbers, bad as they are, vastly understate the prob-
lem. The private sector numbers include many people in small local financial services companies, and they don’t include lobbyists. Average compensation for all Goldman Sachs employees, for example, has fluctuated between a mere pittance of $433,000 in 2010 and its record high of $661,000 in 2007, when it was still selling mortgage-backed junk but had already started to bet against it as well. Senior Goldman executives make vastly more, and you can be sure that Goldman pays its lobbyists very, very well.

Thus, in the end, by industrial standards it proved shockingly inexpensive to purchase federal policy; and keeping public sector salaries low made it even easier to buy influence. Combining campaign contributions, lobbying, revolving-door hiring, and payments to academic experts, the whole process probably costs no more than $20 billion a year, perhaps 1 percent of total U.S. corporate profits. For this trivial sum, America’s most incompetent and predatory industries could obtain favorable political and regulatory treatment, reducing their need to be more productive, honest, or competitive.

In this process, the financial sector first became an enthusiastic follower and then, by the 1990s, the leading user of money-based political strategy. As the financial sector grew more powerful, more concentrated, and more politically active, it arguably became the first major industry to use lobbying and policy primarily for offensive and predatory, rather than defensive, purposes.

It was under the Clinton administration that the really heavy lifting started for financial services. In fairness, Clinton did some very good things in economic policy. He stopped the deficit spending. He initiated the last major antitrust action in the United States (against Microsoft, although the Bush administration later ended it with a trivial settlement). He also tried to open the telecommunications industry to real competition, including in broadband services, through the attempted grand bargain of the Telecommunications Act of 1996. And Clinton did several very productive things to support the Internet revolution, including legalizing commercial Internet services and privatizing the Internet backbone in 1994–95.
However, the Clinton administration also tilted decisively toward the wealthy and the financial sector, a fateful choice whose full consequences Clinton himself may not have understood at the time. Then George W. Bush finished the job, completely neutering the regulatory and law enforcement systems. And so America got the bubble and then the crisis.

But then, in 2008, with the global financial system on the brink of collapse, Barack Obama presented himself during his presidential campaign as the reformer who would bring the financial sector under control and restore fairness to America. Instead, he screwed us.

**Mr. Obama's Wall Street Government**

BARACK OBAMA WAS elected with an overwhelming mandate for change, and the best political opportunity since the Depression to achieve it. He won because of reformist and idealistic campaign statements, and the unprecedented popular mobilization efforts they generated. His party obtained overwhelming majorities in both houses of Congress, and he took office with the nation in deep crisis, still on the brink of financial catastrophe and with unemployment increasing by half a percent per month. The banks were still in desperate trouble, and the federal government had enormous power over them. The federal government owned major pieces of AIG, Citigroup, and Bank of America; it was supporting all the others through TARP and Federal Reserve loans; Goldman Sachs and Morgan Stanley had agreed to become bank holding companies, which made them subject to Federal Reserve and FDIC regulation. Ben Bernanke's first term as Federal Reserve chairman was ending soon, giving Obama enormous leverage over him, and the ability to replace him if he didn't perform. If ever there was a chance to do something in Washington, DC, this was it. And yet we got just another oligarch's president.

The first troubling sign was his personnel appointments. Not a single critic or voice of reform got a job—not Simon Johnson, Nouriel
Roubini, Paul Krugman, Sheila Bair, Joseph Stiglitz, Jeffrey Sachs, Robert Gnaizda, Brooksley Born, Senator Carl Levin, none of them.

Instead we got Larry Summers, the man behind nearly every disastrous policy that created the crisis, fresh from making $20 million from hedge funds and investment banks, as director of the National Economic Council. (When Summers left office in early 2011, his replacement was Gene Sperling, who had received a $1 million consulting fee from Goldman Sachs for guidance in its nonprofit work.) Tim Geithner, who had been president of the New York Federal Reserve Bank throughout the bubble, was put in charge at Treasury. Geithner chose a former Goldman Sachs lobbyist, Mark Patterson, as his chief of staff. One of his senior advisors was Lewis Sachs, formerly overseer of Tricadia, one of the hedge funds that made billions by helping banks structure mortgage securities for the purpose of Tricadia betting against them. Geithner’s choice for undersecretary for domestic finance was Jeffrey Goldstein, a private equity executive. Geithner’s deputy assistant secretary for capital markets and housing finance (the person most directly responsible for cleaning up the housing mess) was Matthew Kabaker, an executive at Blackstone, America’s largest private equity firm.

The new president of the New York Fed was William C. Dudley, who had been chief economist of Goldman Sachs throughout the bubble, and coauthored with Glenn Hubbard the paper I described earlier, which proclaimed the triumph of financial markets and the role of derivatives in softening recessions. And then, of course, Obama reappointed Ben Bernanke.

Almost all regulatory appointments followed that pattern. Gary Gensler, a former Goldman executive who had previously helped push through the ban on derivatives regulation, became chairman of the Commodity Futures Trading Commission, which regulates derivatives. Mary Shapiro, who had run the Financial Industry Regulatory Authority, the investment banking industry’s worthless and timid self-policing body, moved over to run the Securities and Exchange Commission (after receiving a $9 million severance). For the SEC’s new
director of enforcement, Ms. Shapiro chose Robert Khuzami, who had been (since 2004) general counsel for the Americas for Deutsche Bank.

Mr. Khuzami was a particularly stunning choice, since he must have been deeply involved in the legal approval process for the many unethical actions of Deutsche Bank’s U.S. subsidiary during the bubble. Deutsche Bank didn’t have Goldman Sachs’s laser-focus top-management ruthlessness, but it wasn’t a naive boy scout either. It held a large mortgage portfolio, on which it took some losses, but it hedged aggressively, thereby keeping its losses to under $5 billion. Greg Lippmann, head of the Deutsche Bank CDO trading desk, actively shorted the mortgage market, making $1.2 billion for Deutsche. Lippmann also worked with John Paulson and Magnetar to create deals that they could bet against. (As a joke, Lippmann passed out T-shirts to his employees that said “I’m Short Your House.”) And like the other banks, Deutsche Bank started unloading its junk on the unsuspecting. Indeed, Lippmann himself occasionally continued to sell CDOs to Deutsche customers, in some cases referring to the products as “crap” and the customers as “dupes.” In a June 2007 e-mail message, a Deutsche Bank managing director, Richard Kim, wrote to Lippmann that Deutsche would package unsold pieces of CDOs into a CDO squared, and sell them as a “CDO2 balance sheet dump.”10 The Levin-Coburn report issued in 2011 lists several cases in which risks of CDOs discussed internally were not mentioned in public offering materials. How much did Mr. Khuzami know? We don’t know that, but appointing Mr. Khuzami certainly sent a very bad signal about the administration’s interest in prosecutions. And, indeed, Mr. Khuzami’s record has been a depressing validation of that signal.

The same was true of Obama’s choice to run the criminal division of the Justice Department, Lanny Breuer. Breuer had been cochair of the white-collar defense and investigations practice at Covington & Burling, a law firm also heavily involved in corporate lobbying. (Between 2001 and 2007, Attorney General Eric Holder was also at Covington & Burling.) While Breuer and Holder were partners at the firm, its clients included Bank of America, Citigroup, JPMorgan Chase, and Freddie
Mac. The firm was also involved in creating MERS, the banking industry consortium now being sued by the state of New York in connection with foreclosure abuses. Other Covington clients included Halliburton, Philip Morris, Blackwater, and Enron executives; Breuer personally represented the Moody’s rating agency in relation to Enron, and has also represented Halliburton. Breuer and Holder have declined to state whether they have been forced to recuse themselves from any financial crime investigations. More recently Covington & Burling has represented many individuals and firms involved in the financial crisis, including Indymac, an unidentified Big Four accounting firm, Sterling Financial/PNC, and others; it has also lobbied the SEC, on behalf of a coalition of financial firms, to weaken the Volcker rule.

Eric Holder’s deputy chief of staff, John Garland, and Lanny Breuer’s chief of staff, Steve Fagell, both also came from Covington & Burling, and both have now returned there to work on white-collar defense cases and regulatory issues. At DOJ, Fagell had been in charge of coordinating DOJ’s financial fraud task force. After returning to Covington, he began “representing” (not “lobbying for”—that would be illegal, given how recently Mr. Fagell had left the government) a coalition of financial firms in their efforts to persuade the SEC to weaken the whistle-blower provisions of the Dodd-Frank law. Mr. Fagell also “represents” various other banks and financial executives in regard to various regulatory, legal, and policy disputes.

Even senior Obama administration foreign policy and national security positions were filled by bankers, including several who had been deeply involved in, and profited from, the financial bubble. Michael Froman, who was appointed to lead economic policy at the National Security Council, had been an executive in Citigroup Alternative Investments, a unit that was deeply involved in the financial crisis and subsequently lost billions of dollars. Froman started working on Obama’s transition team while still employed at Citigroup, and Citigroup awarded him his final bonus after his appointment was announced in January 2009. Under media pressure, Froman gave that bonus to charity. But Froman still made over $7 million at Citigroup.
Jacob Lew, who had been CFO of the same Citigroup unit, became the deputy secretary of state and then, in 2010, Obama’s choice to run the Office of Management and Budget. In 2012 he became Obama’s chief of staff when Bill Daley resigned.

The new deputy secretary of state for management and resources was Thomas Nides, brought over from Morgan Stanley, where he had been chief administrative officer. I had met him there once, introduced by Laura Tyson after our final conversation. Ah, yes, he said, he knew Laura from the Clinton administration; he had been in the administration too, “before I sold out.” Yes, he really did say that to me.

Obama’s—or Hillary Clinton’s—undersecretary of state for economic affairs was Robert Hormats, previously vice chairman of Goldman Sachs International. Richard Holbrooke, the State Department’s special envoy to Afghanistan and Pakistan until his death in 2010, had been on the board of directors of AIG and AIG Financial Products. Tom Donilon, Fannie Mae’s chief lobbyist between 1999 and 2005, became deputy National Security Advisor in 2009 and then, in late 2010, the National Security Advisor. The flow in the reverse direction began soon afterward; Peter Orszag, Obama’s first head of the Office of Management and Budget, resigned in 2010 to become vice chairman of Citigroup.

The fears immediately prompted by this pattern of appointments have proved fully justified. From the outset, Obama opposed serious reform of corporate governance, breaking up the largest banks, or closing legal loopholes. It is still not per se illegal, for example, to create and sell a security for the purpose of betting on its failure. Obama also opposed efforts to reform or control financial industry compensation—even for firms dependent upon federal aid, as almost all of them were in the immediate aftermath of the crisis. There was a long period of total inaction, followed by a weak and ridiculously complicated reform bill (Dodd-Frank). There has been almost no significant action on the foreclosure crisis, and the White House played little or no role in the investigations undertaken by the Senate Permanent Subcommittee on Investigations and the Financial Crisis Inquiry Commission. In fact,
the administration deliberately kept the FCIC’s budget to a mere $6 million, sharply limited its subpoena power, and scheduled its report to appear only after the 2010 midterm elections.

Most tellingly, the new Justice Department’s complete lack of interest in prosecuting banks and bankers soon became painfully obvious. White-collar and financial crimes were given low priority, and the administration chose not to appoint a special prosecutor, or create a task force, to investigate and prosecute major crimes related to the bubble and crisis. Investigations against Countrywide, Angelo Mozilo, AIG, Joseph Cassano, and others were dropped. The few financial crime cases brought forward, such as those involving Wachovia’s bid rigging and money laundering, were settled with deferred prosecution agreements and fines. As a consequence, as of early 2012 there still had not been a single crisis-related criminal prosecution, of either a firm or an individual senior financial executive, by the Obama administration—literally zero.

The SEC has brought only a handful of civil cases, ending in mostly trivial fines, with neither firms nor individuals required to admit any wrongdoing. In not a single case has an individual executive been required to pay more than a tiny fraction of either his net worth or his gains from the bubble.

In fact, when a few courageous state attorneys general, particularly Eric Schneiderman of New York, tried to get just a little tough with the banks in 2011 (in several civil cases), the Obama administration pressured them to stop. Senior Obama officials and their proxies, including the secretary of housing and urban development, called Schneiderman directly and told him that he should accept the sweetheart deal that the administration favored, whose terms included surrendering all future rights to sue the banks for fraud.

But then came the Occupy Wall Street movement, the 60 Minutes two-part series in December 2011 on the lack of criminal prosecutions, and, above all, an election year in 2012. So, suddenly, four years after the crisis, in his January 2012 State of the Union address, President Obama decided to announce a federal-state task force focused on finan-
cial crime, and that New York state attorney general Eric Schneiderman would co-chair it. The other co-chair, however, is Lanny Breuer, the same head of the same criminal division that hadn’t brought any cases for four years. The task force was assigned a total of ten (yes, ten) FBI agents, and when fully staffed will have a grand total of fifty-five employees.

Shortly afterward, we saw the predictable political results. Three Credit Suisse traders were arrested for a trivial fraud allegedly committed in 2007, and which victimized Credit Suisse rather than investors or homeowners. Then the state foreclosure cases were settled for $26 billion. Less than a million people who have lost their homes will receive checks averaging $2,000 each. Another million will receive some degree of mortgage relief. Over twenty million others whose mortgages are underwater, or who have lost their houses to foreclosure, will receive nothing. As of this writing, there have still been no arrests or indictments either of major firms or senior executives related to causing the bubble, the crisis, or subsequent foreclosure abuses.

Obama has been similarly inert with regard to financial compensation, at either the corporate or individual level, even as foreign governments took action. In 2009, Britain enacted a 50 percent tax on banking bonuses. Then in September 2009 Christine Lagarde (then France’s finance minister) and six other European finance ministers published a joint letter in the Financial Times calling for the G20 nations to enact strong measures to bring financial compensation under control, arguing that “the bonus culture must end.” Most of the G20 nations did in fact adopt compensation controls, including mandatory clawbacks of bonuses when losses occur subsequently. The Obama administration had no comment. Later, in 2010, the Federal Reserve and the SEC issued regulations, but they were exceedingly weak and little has changed.

In contrast, in 2012, such clawbacks were in fact implemented in Europe, forcing senior executives of Barclays, Lloyds, and several other European banks to surrender millions of dollars each in prior bonus payments.
Thus far there have been no executive bonus clawbacks by regulators in the United States. At both corporate and industry levels, the same major conflicts of interest remain embedded in the financial system. Accounting firms performing audits are still paid by the firms they are supposed to audit. Rating agencies are still paid by the issuers of securities. Traders, executives, and members of boards of directors still receive large amounts of cash relative to stock.

In short, the Obama administration’s policies toward the financial sector are nearly indistinguishable from those of its predecessors, regardless of political party. What happened here?

First, the Democratic Party has changed—not so much its popular base, but its funding sources. For most of the twentieth century, and certainly from the Depression through the 1970s, the Democrats were reliably the party of unions, of working families, and the poor, while the Republicans were reliably the party of business. That divide was dramatized many times during the Great Depression, but it endured for decades afterward. It showed in 1962, in John F. Kennedy’s confrontation with the steel industry, whose major firms often behaved like a cartel. The Kennedy administration had brokered a labor agreement with the steel unions and was shocked when the companies immediately increased steel prices together, even though Kennedy’s agreement had kept wage costs down. Kennedy held a brief, blistering press conference that forced the companies to back down. The punch line actually drew applause from the reporters:

A few gigantic corporations have decided to increase steel prices in ruthless disregard of the public interest. Some time ago I asked each American to ask what he could do for his country. Today Big Steel gave its answer.

But that was your parents’ Democratic Party. In the new Democratic Party, when President Obama hosts a White House State Dinner in January 2011 for Hu Jintao, the president of China, he invites Lloyd Blankfein and Jamie Dimon. In fact, Mr. Blankfein had visited the
White House ten times as of early 2011, including several times during the period that his firm had been charged with fraud by the SEC.

The subordination of mainstream Democrats to the financial oligarchy’s agenda first became apparent during the Clinton administration, whose policies, as we have seen, were sharply more favorable toward the wealthy and the financial services sector than those of any Democratic administration in the last century. That the control of the oligarchy became even greater during the Bush administration goes without saying.

But what is perhaps most revealing is that Obama continued in Bush’s footsteps, even though he had an unprecedented opportunity to change course. How to explain this?

America’s Political Duopoly

America has experienced a profound realignment of its politics over the last generation, driven by a combination of globalization, American economic decline, and the rising use of money to shape American politics and government policy. The core of this realignment is that the two political parties now compete for money, while colluding to hide this fact. They provide the appearance, and often the reality, of fierce partisan conflict on social and “values” issues, whereas on the issues of critical concern to the financial sector and America’s economic oligarchy, their actions are almost identical. We have, in short, a political duopoly—a cartel formed by the two parties that, between them, control all of American politics.

At first glance, the suggestion that both parties are colluding and under the influence of a single oligarchy seems absurd. There are red states and blue states; the two parties are viciously polarized. And there is real political conflict in America, especially on social issues that matter to the two parties’ bases—abortion, gay marriage, sex education versus religion in schools, creationism and evolution, guaranteed-health-insurance-as-socialism, taxes-and-government-as-evil, gun control,
welfare, drug policy, immigration, environmental policy, the reality of global warming. These are very real, very important issues; and on these issues, each political party can credibly tell its base that defeat would mean real, painful losses.

But that is exactly the point. It’s a brilliant strategy. These social and “values” conflicts serve excellently to divide and distract people who should, and perhaps otherwise would, be dangerously united in feeling that they were being raped by their CEOs, their bankers, their elected leaders, and the political establishment. Thus, each party can continue to command the grudging support of people who fear that if the other side won, they would lose something important, which leaves the two parties free to collude on the most important thing to both of them—money.

Of course, not everyone likes this new arrangement. Even many wealthy people and some major industries are disturbed, and even directly harmed, by America’s descent into political corruption, financial instability, and economic decline. Information technology, both in Silicon Valley start-ups and major firms, is one example, and it is hardly alone; many industries suffered as a result of the crisis, and continue to do so. But for the most part, even these people and groups dare not resist, or find it not in their interest to do so. The wealthy, and the businesses they own and run, depend upon access to the increasingly separate, private financial system operated for the wealthy by the big banks, hedge funds, and private equity firms. Functions such as private banking, wealth management, estate and trust planning, tax minimization, mergers and acquisitions, initial public offerings, and securities issuance are now dominated by a small number of large financial firms. Moreover, in some regards, such as individual taxation, the interests of senior executives in all industries are aligned with those who run the financial sector. And successful individuals of conscience are not a concentrated, naturally cohesive industry, whereas finance and the ultrarich are, so it’s not really a contest.

Consequently the rational decision is to adjust, rather than try to reform the system. This is particularly true of high technology, which is
the only other industry whose wealth and power could potentially rival the financial sector's.

Consider, for example, the political and lobbying interests of Apple, a firm correctly regarded as a remarkable testament to American high technology. Apple engages in no manufacturing; its manufacturing contractors are Taiwanese-owned companies whose headquarters are in Taiwan, but most of whose operations and employees are in China. (At least Apple still designs its own products; many American electronics companies don't anymore.) These firms, in turn, use Taiwanese and Chinese engineers and managers, predominantly Chinese manual labor (their factories are in China), and a combination of Japanese, German, Taiwanese, and Chinese capital equipment.

For Apple and others like it, this outsourcing decision is entirely rational; but its economic and political implications are enormous. Apple has approximately 70,000 employees worldwide. Just one of Apple's Taiwanese-Chinese manufacturing contractors, Foxconn, has 1.3 million employees. While perhaps three-quarters of them are relatively unskilled manufacturing workers, several hundred thousand of them are engineers, managers, accountants, and other professional employees. Moreover, the technology level of Foxconn's operations (and of Chinese manufacturing generally) is rising rapidly. In 2011 Foxconn announced that due to labor shortages and increasing demand, it was purchasing 300,000 robots for its Chinese factories. The process of selecting, installing, programming, and maintaining those robots will require a large number of highly skilled employees, almost none of them American.

Apple's decisions in this regard are no longer motivated entirely by labor costs. The infrastructure and skills to manufacture its products no longer exist in the United States. American schools no longer produce enough people with enough skill to enable such manufacturing facilities to be designed, constructed, and operated in the United States. But Apple doesn't need its products to be manufactured in the United States; in fact, its use of Chinese manufacturing is critical to obtaining full access to the Chinese market. And Apple, like other U.S.
high-technology companies, is now far less dependent on the U.S. market than previously. In 2011 less than 40 percent of Apple's revenues, and less than 20 percent of its growth, came from North America.

So Apple, Hewlett-Packard, and Dell are not going to declare war on Wall Street over the future of the American labor force. Indeed, some high-technology companies share the financial sector's interest in gutting regulation and antitrust enforcement. Everyone likes lower corporate taxes. Google now holds over 60 percent of the U.S. Internet search market, and its share is growing, so they're not so excited about strong antitrust policy, either. So American high technology may not always like how the financial sector behaves, but it won't wage war against it. Similarly, the technology sector isn't going to go to war over universal high-speed broadband service or public education.

America's new money-driven political system also has strong self-reinforcing characteristics. The more wealthy, concentrated, and powerful America's financial sector and wealthiest families become, the more they affect policy in their favor; the more policy tilts in their favor, the wealthier and more powerful they become. Similarly, the system makes it difficult to mount truly effective third-party challenges or insurgencies within the two major parties. The electoral college system in presidential elections makes it difficult for a third party to become the deciding swing vote for the presidency. Nor does America have a parliamentary system that might give a new third party a critical swing vote in choosing a leader. Similarly, very few American cities or states have ranked-order voting, which would prevent third party votes from being wasted. Over the last quarter century, gerrymandering of election districts (engineering their borders to control voting outcomes) has produced increasing "security" of congressional districts, with incumbents rarely unseated. And, as a major fundraiser for the Democratic Party recently told me, the one thing that both parties can always agree on is the undesirability of third parties.

There is still some difference between the two parties. The Democratic Party is still more progressive than the Republicans on matters of individual economic opportunity, education, personal taxation, the
social safety net, environmental policy, and safety regulation. And for
now, disbelief in evolution, vaccines, and climate change remains a
uniquely Republican aberration. But the margin of difference between
the two parties, at least on economic issues important to business and
finance, as opposed to individuals, has narrowed sharply. As the power
of the financial sector and the wealthy has increased, the entire politi-
cal spectrum has shifted toward the wealthy on economic issues, and
the Democrats have shifted along with it.

And thus, Americans are stuck. There is now little difference on
where the parties stand toward regulation of Wall Street or other con-
centrated and regulated industries (telecommunications, energy, the
media), or the role of money in politics, including the revolving door.
America is increasingly in the hands of a cynical political duopoly
whose policies are antithetical to economic progress and fairness.

Obama’s failure to act has been blamed on his inexperience, his un-
familiarity with finance and business, and a personal tendency to avoid
conflict (or, to be blunt, on his being a coward). Some, including my
colleague Charles Morris, also feel that the political system is now so
gridlocked and dysfunctional that transformative policy changes are
simply no longer feasible by anyone, so that Obama really couldn’t have
done anything even if he had tried. If so, then we’re really screwed. But
if anyone had a shot, it was Barack Obama in 2009, and he didn’t try.
Admittedly, it would have taken real personal courage, and it would
have been a hard fight—Wall Street would not have just rolled over.
The logic and incentive structures of America’s political duopoly are
such that in taking the path of least resistance, Obama was surely act-
ing in his, and his party’s, rational self-interest. But whatever Obama’s
personal motivations, America (and indeed the whole world) will pay
dearly for his failure for a long time.

Let us now turn to the pain that America suffers under this regime.
Inequality, Stagnation, and the Decline of American Opportunity

BOTH IN PERSONAL conversations and in the statistics, I sense a change among America’s young, who increasingly display both a pervasive cynicism about politics (particularly after Obama turned out to be business as usual) and also, unless they are in the upper 5 percent or so, a fatalism about their personal career prospects. Their general view is: if you have rich parents, a computer science background, or an MBA, you’re okay; otherwise, you’re not okay, and if you want to change that and make some money, you had better concentrate really hard on pleasing the boss. Outside of Silicon Valley and Wall Street, the America of possibility, openness, progress, and opportunity seems increasingly distant. Most older Americans, in contrast, still do not seem to realize how unfair their society has become over the last generation unless they have become victims of it themselves.

First, the numbers. Since 1980, there has been a pronounced shift of taxable income toward the top tenth. As the top chart on the next page illustrates, their share of all reported income, including capital gains, grew from a bit over a third in 1980 to virtually half (49.7 percent), in 2007. The top tenth’s share of income in 2007 is the highest on record, just above the 49.3 percent share garnered by the top tenth in 1928, the year before America entered the Great Depression.

Even more remarkable, however, is the growth of inequality within the top tenth, as the bottom chart shows. Since 1980, the top tenth has increased its share of income by about half. But the share of the top 1 percent of taxpayers more than doubled, from 10 percent of total income in 1980 to over 20 percent in 2010. And what is truly stunning is that by 2007, the top one-hundredth of the top 1 percent, less than twenty-five thousand households, earned more than 6 percent of all national income—nearly $1 trillion. This percentage was considerably higher than the previous record, also set in 1928. This striking divergence of share gains within the top tenth is shown in the second chart on the next page, taking the respective shares in 1980 as 100.
Income Share of the Top Tenth, 1917-2008


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Share Gains Within Top Tenth of Taxpayers, 1980-2008 (1980=100)

Moreover, these changes occurred when most American households actually found their real incomes stagnant or declining. Median household income for the last four decades is shown in the chart above.

But this graph, disturbing as it is, conceals a far worse reality. The top 10 percent did much better than everyone else; if you remove them, the numbers change dramatically. Economic analysis has found that "only the top 10 percent of the income distribution had real compensation growth equal to or above...productivity growth." In fact, most gains went to the top 1 percent, while Americans in the bottom 90 percent either had declining household incomes or were able to increase their family incomes only by working longer hours. The productivity of working Americans continued to grow, particularly with the Internet revolution that began in the mid-1990s. But the benefits of productivity growth went almost entirely into the incomes of the top 1 percent and into corporate profits, both of which have grown to record highs as a fraction of GNP. In 2010 and 2011 corporate profits accounted for
over 14 percent of total GNP, a historical record. In contrast, the share of U.S. GNP paid as wages and salaries is at a historical low and has not kept pace with inflation since 2006.\(^{15}\)

As I was working on this manuscript in late 2011, the Census Bureau published the income statistics for 2010, when the U.S. recovery officially began. The national poverty rate rose to 15.1 percent, its highest level in nearly twenty years; median household income declined by 2.3 percent. This decline, however, was very unequally distributed. The top tenth experienced a 1 percent decline; the bottom tenth, already desperately poor, saw its income decline 12 percent. America's median household income peaked in 1999; by 2010 it had declined 7 percent. Average hourly income, which corrects for the number of hours worked, has barely changed in the last thirty years.

Ranked by income equality, the United States is now ninety-fifth in the world, just behind Nigeria, Iran, Cameroon, and the Ivory Coast.

This is not distinguished company. And it's not a statistical fluke. Americans don't like to face this, but America now has a true, increasingly permanent underclass living in near-subistence conditions. There are now tens of millions of Americans whose condition is little better than many people in poor third-world nations. If you add up lifetime urban ghetto residents, illegal immigrants, migrant farm-workers, those whose criminal convictions sharply limit their ability to find work, those actually in prison, those with chronic drug-abuse problems, crippled veterans of America's recently botched wars, children in foster care, the homeless, the long-term unemployed, and other severely disadvantaged groups, you get to tens of millions of people trapped in very harsh, very unfair conditions, in what is supposed the wealthiest, fairest society on earth.

At any given time, there are over two million people in U.S. prisons; over ten million Americans have felony records and have served prison time for non-traffic offenses. Many millions more now must work very long hours, and very hard, at minimum-wage jobs in agriculture, retailing, cleaning, and other low-wage service industries. Sev-
eral million have been unemployed for years, exhausting their savings and morale. Twenty or thirty years ago, many of these people would have had—and some did have—high-wage jobs in manufacturing or construction. No more.

But in addition to growing inequalities in income and wealth, America exhibits growing inequality of opportunity, both economically and in all the determinants of a healthy, happy, secure life, ranging from health care to nutrition.

There are many facets to the decline in fairness and opportunity in American life. Perhaps the worst are the conditions now imposed upon young children born into the underclass and subjected to the recent evolution of American education. They are related, and they reinforce each other; their combined result is to condemn tens of millions of American children, particularly those born into America’s new underclass, to a life of hardship and unfairness. For any young child whose parents don’t have money, or who is the child of a migrant agricultural worker and/or an illegal immigrant, America’s prenatal care, preschool, day care, after school, school nutrition, and foster-care systems are nothing short of appalling. And then comes school itself. Nowhere is America’s rapidly growing denial of opportunity more severe or more devastating to the nation’s economic future than in education.

The American dream, stated simply, is that no matter how poor or humble your origins—even if you never knew your parents—you have a shot at a decent life. America’s promise is that anyone willing to work hard can do better over time, and have at least a reasonable life for themselves and their own children. You could expect to do better than your parents, and even be able to help them as they grew old.

More than ever before, the key to the American dream is education. The rise of information technology, and the opening of Asian economies, means that only a small portion of America’s population can make a good living through unskilled or manual labor. But instead of elevating America’s educational system and the opportunities it should provide, America has been going in exactly the wrong direction. As
a result, America is developing not a class system, but, without exaggeration, a caste system—a society in which the circumstances of your birth determine your entire life.

As a result, the American dream is dying. Increasingly, the most important determinant of an American child’s life prospects—future income, wealth, educational level, even health and life expectancy—is totally arbitrary and unfair. It’s also very simple. American children’s futures are increasingly determined by their parents’ wealth, not by their own intelligence or energy. To be sure, there are a number of reasons for this. Income is correlated with many other things, and it’s therefore difficult to isolate the impact of individual factors. Children in poor households are more likely to grow up in single-parent versus two-parent households, exposed to drugs and alcohol, with one or both parents in prison, with their immigration status questionable, and more likely to have problems with diet and obesity. Culture and race play a role: Asian children have far higher high school graduation rates, test scores, and grades than all other groups, including whites; Latinos, the lowest. So, yes, it’s complicated.

But it’s also simple, really. The largest single factor is the decline in educational opportunity and achievement, which are driven by money. If you don’t have money, you lose—through the declining quality of public education in poor school districts, insufficient day care, inadequate preschool and after-school programs, financial and social pressure to quit school prematurely, and the soaring cost of college, both public and private. The historical accident that American public schools are funded through local property taxes plays a huge role here. As income inequality grows, so does the disparity between poor and wealthy school districts in the tax receipts available to fund schools.

So now, if your parents make enough money, they can live in a good public school district, and if they’re really wealthy, they’ll send you to private schools. The food will be good. You won’t face pressure to drop out to take care of your younger sister; they can send her to day care or hire a babysitter. They’ll buy you a computer, and piano lessons. Someone will be home, and you won’t be left to fend for yourself on
the streets. But if your parents don’t have the money and they need to work two jobs, or if your parents have succumbed to alcohol or drugs, none of those nice things will happen, and you’ll go to bad schools, and probably drop out of high school.

Increasingly, America has three parallel educational systems. There is an extremely high-quality, elitist, extremely expensive private system for the upper 5 percent or so. Second, there is a reasonably good system for comfortably middle-class professionals who can live in good public school districts and send their children to college. And then, there is a truly awful system for everyone else. The “everyone else” is now at least a quarter, and by some criteria may be nearly half, of the American population. That’s a lot of people to waste.

America’s high school graduation rate is difficult to estimate accurately, in part because government statistics at all levels—federal, state, local—often cover up the situation. But despite estimates that range surprisingly widely, the basic facts are clear. America’s high school graduation rate is much lower than it should be, and it is declining, both absolutely and relative to the rest of the world. So is the quality of public education, even for those who do graduate. Anyone from Asia, or most of Europe, can tell you that most American high schools are a joke. And America’s high school graduation rate is already inferior to that of most other developed nations, including those where graduating from high school means much more than it does in America. The best estimates place the current American high school graduation rate at 75–80 percent. Since graduation rates from exclusive private high schools are nearly 100 percent, America’s public high school graduation rate is probably under 75 percent, and may be as low as 70 percent. In contrast many European and Asian nations have graduation rates of around 90 percent.

And, as with private planes and private elevators, so with private education; there has arisen an increasingly segregated system of private elementary and high schools for the wealthy. It’s not very subtle. Where does John Paulson send his kids to school? His twin daughters attended preschool at the 92nd Street Y, which costs over $20,000 per student
per year—yes, for preschool. Paulson is on their board. He also manages some of their investments, which he has guaranteed against losses. Many other board members have sent children to the school; four of them also manage money for the institution. This is not unusual. One of Mr. Paulson’s daughters, having left nursery school behind, now attends Spence, another exclusive private school in Manhattan. Mr. Paulson is on their board too.\textsuperscript{16}

Equally disturbing are trends in higher education. When I attended the University of California, Berkeley, in the mid-1970s, tuition for California residents was less than $700 per year. In 2011 undergraduate tuition for state residents was $14,260. Private universities have displayed similar changes. When I entered MIT as a first-year graduate student in 1978, annual tuition was $4,700. For the 2011–12 academic year, it was $40,460. In that same year, Harvard’s tuition was $36,305. Harvard estimated its total annual costs (tuition, fees, room and board, supplies) at $52,652; so the total cost of sending your child to Harvard for four years, even assuming no further cost increases, was already over $210,000.

Harvard, and most other elite private schools, claim that their admissions are merit-based and need-blind, and that everyone who qualifies will receive enough financial aid to attend. This is bullshit, of course. If your parents went to Harvard (or Yale, Princeton, etc.) and have donated money, or if your father runs a huge global bank or is prime minister somewhere, your chances are surely somewhat improved. But forget about that—just look at the money and the students. In the 2011 academic year, Harvard’s administration proudly announced that slightly over 60 percent of its undergraduates received some level of financial aid and also stated that no student whose family earned less than $180,000 per year would be required to pay more than 10 percent of their total costs.\textsuperscript{17}

Think about that for a minute. If you’re a Harvard student who receives no financial aid at all, you come from a family that makes \textit{much} more than $180,000 per year. Let’s say the eligibility cutoff for receiving any financial aid at all is $300,000 (Harvard doesn’t reveal the number).
This means that nearly 40 percent of Harvard undergraduates came from families whose income is at the very upper end of the American income distribution. This means that Harvard’s income distribution is probably even more skewed than America’s: in the nation as a whole, in 2010 the top 1 percent of families received about 20 percent of all annual income.

At the same time as tuition is rising, there is a widening gulf in quality and resources between private universities and the public universities and community colleges that have traditionally provided the majority of educational opportunity for poor students. As income inequality has grown, donations to private universities have grown, as have their endowments, while government support for public education has stagnated or declined. As a result, between 1999 and 2009, spending per student at private universities grew from about $29,000 to nearly $36,000, while spending per student at community colleges remained nearly flat at about $10,000 per student. Since 2008, the situation has worsened; tuition at public universities and community colleges has increased sharply, while spending per student has declined, in some cases by more than 20 percent. The University of California, the largest and best public university in the world, has seen its budget cut by over 20 percent since the financial crisis.

But there is yet another way in which America has become less fair, and it is even more disturbing than the growth in economic and educational inequality. It is this: increasingly, in America, you make more money by being crooked and destructive than you do by being productive and honest. Thankfully this isn’t true everywhere—brains, work, and reputation still count in many places. (Once again, high technology stands out.) But in a sharply increasing, already frighteningly high percentage of American society, honesty is now a major professional and financial liability.

This pattern started, not surprisingly, in the same place as America’s economic decline: the highly concentrated American industries that had become severely inefficient by the 1980s. The people who mismanaged America’s automobile, steel, and telecommunications indus-
tries did not, in general, suffer for their incompetence. They stayed in their jobs and kept their perks, while their companies deteriorated. But now, with the financial sector and its friends free from any risk of prosecution, America has taken looting to a whole new level.

The Ultimate Insult: The Financial Penalty for Being Decent

ANYONE WHO HAS ever lived or worked in a corrupt dictatorship knows what happens. When the system is rigged, when ordinary citizens are powerless, and when whistle-blowers are pariahs at best, three things happen. First, the worst people rise to the top. They behave appallingly, and they wreak havoc. Second, people who could make productive contributions to society are incented to become destructive, because corruption is far more lucrative than honest work. And third, everyone else pays, both economically and emotionally; people become cynical, selfish, and fatalistic. Often they go along with the system, but they hate themselves for it. They play the game to survive and feed their families, but both they and society suffer. In America, this issue is rarely mentioned in public or in the media, but in my personal experience it is increasingly discussed in private conversation.

Consider now the high-income, high-education sectors that are the principal subjects of this book: financial services, academia, politics, and policy making. Over the last several decades, the financial sector has sharply increased its share of GNP, total corporate profits, and employment. Its income per employee is now double the national average, and people at the top of the financial world today make phenomenal amounts of money. Over the same period, the industry’s ethical standards deteriorated sharply.

Over the last decade executives, salespeople, and traders in the financial sector made truly obscene sums, by doing truly obscene things. With a few exceptions, the worst offenders made the most money. None of them have been prosecuted, and none of them have been forced to
return the money. Most of them have kept their jobs. Even those who
destroyed their own firms have remained both free and extremely
wealthy. Jimmy Cayne saw his net worth decline from about $1.5 bil-
lion to a mere $600 million or so after Bear Stearns collapsed, but
he can probably survive on that. Stan O’Neal received a severance of
$161 million for being greedy and incompetent at Merrill Lynch. Henry
Paulson made something like half a billion dollars turning Goldman
Sachs into an organization that made money betting against its cus-
tomers, and his successor Lloyd Blankfein hasn’t done badly either. An-
gelo Mozilo still has his half a billion too. And so on.

Even worse, consider what it was like to be an honest person in one
of those firms. We don’t know if anyone ever knocked on Lloyd Blank-
fein’s door and said, Listen, Lloyd, it isn’t very nice to tell the world to
buy this stuff when we know it’s awful and we’re making billions of
dollars betting against it. And you shouldn’t lie to Congress about it,
either. Did anyone ever say that to Lloyd? Probably not. But if someone
ever did tell him that, I rather doubt that he or she received an imme-
diate promotion and a big bonus. And we do know what happened to a
number of people, in various firms including Citigroup, Merrill Lynch,
Countrywide, AIG, and others, who tried to call attention to the un-
ethical and unsustainable behavior they saw. Almost without excep-
tion, they were severely penalized for it.

And yet, anyone graduating from business school, law school, or
anyplace else anytime in the last two decades certainly noticed that fi-
nance was the quickest, surest way to get rich. This diverted a consid-
erable number of America’s smartest, most ambitious, best-educated
people from productive work into quasi-criminal activities that have
damaged, not improved, America’s economic welfare. And while the
financial bubble was the largest and worst of these activities, it was far
from the only one.

Something similar now holds for economics and other academic
disciplines relevant to politics and regulation (law, political science, and
public policy). Which economists, finance professors, and industrial
economists have made the most money, obtained the most senior posi-
tions, become the most famous, testified in Congress most frequently? Larry Summers, Glenn Hubbard, Laura Tyson, Frederic Mishkin, Martin Feldstein, Alan Greenspan, Hal Scott, Richard Schmalensee, Jerry Hausman...

Given this parade, put yourself in the shoes, once again, of someone young and honest, particularly someone who wants to do research on; say, the financial crisis. As we noted above, you would face a sobering tableau. Who would supervise your PhD thesis, judge your grant applications, consider whether to give you tenure, referee the articles you submit to journals? Answer: people who make millions of dollars defending the financial sector. In contrast, who is going to pay you hundreds of thousands of dollars per year to sit on their board of directors, testify in Congress on their behalf, advocate their interests in antitrust cases, appear for them before regulators? Nobody, is the answer.

As for politics, lobbying, and government policy—enough already said. At present, these are not professions that attract and reward the honest and selfless.

This is dangerous. A nation that allows predatory, value-destroying behavior to become systematically more profitable than honest, productive work risks a great deal. America, like all societies, depends heavily on idealism and trust, including the willingness of ordinary citizens to behave honestly and to make sacrifices. While many Americans do not yet realize how unfair their society has become, that condition will not last indefinitely. Unfortunately it will probably last long enough that the current generation of predators will die wealthy and comfortable. But most of us would not enjoy living in a society dominated by cynicism and dishonesty.