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COUNTRY ON FIRE:

THE VIRTUOUS PRODUCER IN THE ERA OF FINANCE CAPITALISM

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ABBREVIATIONS

ACRS	Accelerated Cost Recovery Schedule
CBOT	Chicago Board of Trade
CEBA	Competitive Equality Banking Act
CFMA	Commodity Futures Modernization Act of 2000
CFTC	Commodity Futures Trading Commission
CME	Chicago Mercantile Exchange
CPFC	Commercial Paper Funding Facility
DIDMCA	Depository Institutions Deregulation and Monetary Control Act
FDIC	Federal Deposit Insurance Corporation
FED	Federal Reserve Bank
FHLBB	Federal Home Loan Bank Board
FmHA	Farmers Home Administration
FSLIC	Federal Savings and Loan Insurance Corporation
GAAP	Generally Accepted Accounting Principles
IMM	International Money Market
LOR	Leland O'Brien Rubenstein Associates
NYSE	New York Stock Exchange

PDCF	Primary Dealer Credit Facility
RAP	Regulatory Accounting Principles
ROE	Return on Equity
ROI	Return on Investment
S&L	Savings and Loan
SEC	Securities and Exchange Commission
USDA	United States Department of Agriculture

ABSTRACT

This dissertation examines how congressional and private sector decision makers of the 1980s understood financial production, and how this understanding shaped policy. The years between 1980 and 2008 have been defined as the “Neoliberal Order.”¹ My analysis does not challenge this categorization. However, I aim to refocus the point of rupture from political to economic—from the election of Ronald Reagan to the Volcker Shock. The current literature centers the election of Reagan as the realization of this new era. This framework has merit. Reagan’s election, after all, ushered in free market reforms— principally deregulation, anti-union sentiment, and austerity politics—that have defined U.S. political economy for over forty years. However, I contend that the center of this change rests within the dramatic reshaping of the economic order. Financialization remade how the economy functioned, constraining what was previously thought possible while also creating unintended consequences to political decision making.²

Placing this dramatic economic shift, rather than political, at the center of rupture opens a new path of analysis. Primarily, this project illuminates how confused, chaotic, and contingent the transformation of the political economy during the 1980s was. Despite the perceived success of the Reagan Revolution, the chapters ahead illustrate how there truly was no master plan. Important legislative actions, from tax reform to deregulating the savings and loan industry, were

¹ Gary Gerstle, *The Rise and Fall of the Neoliberal Order: America and the World in the Free Market Era* (Oxford University Press, 2022).

² David Harvey, *A Brief History of Neoliberalism* (Oxford University Press, 2005); Kimberly Phillips-Fein, *Invisible Hands: The Businessmen’s Crusade Against the New Deal* (WW Norton, 2009); Elizabeth A. Fones-Wolfe, *Selling Free Enterprise: The Business Assault on Labor and Liberalism, 1945-1960* (University of Illinois Press, 1994); Daniel Stedman Jones, *Masters of the Universe: Hayek, Friedman, and the Birth of Neoliberal Politics* (Princeton University Press, 2012); Jefferson Cowie, *The Great Exception: The New Deal and the Limits of American Politics* (Princeton University Press, 2016); Kim Phillips-Fein, *Fear City: New York’s Fiscal Crisis and the Rise of Austerity Politics* (Metropolitan Books, 2017); Rick Perlstein, *The Invisible Bridge: The Fall of Nixon and the Rise of Reagan* (Simon and Schuster, 2014); Rick Perlstein, *Reaganland: America’s Right Turn 1976-1980* (Simon and Schuster, 2020).

reactions to quickly changing circumstances that were beyond the direct control—and most importantly, the understanding—of decision makers. Legislation often aimed to use the power of the federal state to save pillars of the postwar era. Farmers, industrial manufacturers, and affordable mortgages all were the focus of major congressional action. But these actions only furthered the transition to a financialized economy, and did very little to help target constituents. Despite the chaos, a new logic emerged. Financiers were recognized as wealth creators, who gave new life to the moribund economy, leading the way for economic growth and prosperity into the coming decades.

I argue that even as financialization wrought a new type of capitalism, older cultural narratives framed understandings of how to formulate and implement policy. Specifically, the virtuous producer ideal continued to shape political imaginations for problem-solving in this new economic era. Finance capitalism required a reworking of the political and cultural imagination to not only what production was, but also who produced wealth and what were the new productive uses of capital. The cultural narrative of virtuous production allowed for the concretized understanding of the political economy in a time of fracture.³

Rather than the overwhelming success of the Reagan Revolution and democratic acquiescence to the magic of the free market, the virtuous producer narrative remained the driving force behind political economic decision making. I argue that the financier replaced the industrial laborer in the 1980s. The complex transition to financial economy followed the older model of industrial production that remained authoritative to congressional decision makers throughout the early and mid-1980s. It was only after a series of unintended consequences of policy—tax reform, real estate expansion, and most importantly, the Wall Street Crash of 1987—that financiers became the key producers in the new economy, thus meriting support by the state.

³ Daniel T. Rodgers, *Age of Fracture* (University of Harvard Press, 2011).

Without understanding this shift, we cannot fully explain the key political-economic transformation of the era. During the postwar era, the mantle of virtuous producer was affixed to the white male industrial laborer. The state took measures to protect this class of Americans by securing collective bargaining, and just as importantly, continuing direct investment through the Cold War military industrial complex. Their income—thus the demand side of the economy—was protected by the state.⁴ After the Volcker Shock, American financial markets became the home to unprecedented foreign investment, creating a type of financial monopoly power—and thus economic growth—that replaced industrial manufacturing. By the end of the 1980s, financial institutions that provided credit and created speculative markets were recognized as the new engines of growth. Financiers representing the supply side of the economy were thus labeled the virtuous producer of the new era.⁵

The Reagan Revolution, and the following Neoliberal Order, were shaped by this new paradigm. Although the supply-side revolution, and attenuating economic instability and inequality, correlate with the transition, the political imaginings of the Reagan right were not the center of change. Rather, an event that preceded Reagan's presidency, the Volcker Shock, created a new economic paradigm that ushered in the transition from industrial to financial production. Congressional action to multiple crises caused by this transformation throughout the Reagan presidency spurred the transformation of the virtuous producer ideal to support the supply side of the economy. Although these political actions had unintended economic consequences, this new framework allows us to understand how a new type of conventional

⁴ Steve Fraser and Gary Gerstle, eds., *The Rise and Fall of the New Deal Order, 1930-1980*, (Princeton University Press, 1989).

⁵ Greta R. Krippner, *Capitalizing on Crisis: The Political Origins of the Rise of Finance* (Harvard University Press, 2011); James K. Galbraith, *The End of Normal: The Great Crisis and the Future of Growth* (Simon & Schuster, 2014).

wisdom emerged from an era defined by chaos and misunderstanding. The virtuous producer remained at the heart of the American political economy.

Chapter 1: The Farm Crisis of the 1980s: Virtuous Production and the Limits of the Reagan Revolution

This chapter demonstrates that the ideal of the virtuous producer was a vibrant concept in 1985, exemplified by the “family farmer.” Public support for these bankrupt farmers repudiated Reagan’s call to let the free market reign. Instead, massive public support for active government action and increased taxes resulted in Reagan signing a Farm Bill that cost more than every other implemented since Franklin D. Roosevelt, combined.

The Farm Crisis also illuminates the complexities of Reagan’s second term. The Republican Party fractured around the debate concerning the proper role of the federal government in subsidizing agribusiness—with, unsurprisingly—midwestern Republicans such as Bob Dole leading the call for passage of the Farm Bill. Furthermore, the chapter examines how the Volcker Shock affected Americans on the ground level, as farmers became “canaries in the coal mine” to the increasing importance of credit and debt would impact all Americans by the end of the decade.

Chapter 2: Acquiescence or Reform?: The Tax Reform Act of 1986 and the Sunrise Politics of the New Democrats

What types of political-economic reform were possible in the 1980s? This chapter explores how tax policy both shaped politics and the economy throughout the 1980s and beyond. Specifically, there are deep connections between the passage of the Economic Recovery Act of 1981 and the Tax Reform Act of 1986. Both tax reform bills were aimed at encouraging industrial growth in the United States—though just how, and even what industrial growth was—

differed between the two political parties. The financial concept of depreciation played a formative role throughout debates over the 1986 tax policy. Most importantly, the attempts at tax reform had massive unintended effects—most notably on the housing market which helped to spur the Savings & Loan expansion and crisis from 1981 to 1986. Congressional debates, policy papers, and popular publications illustrate how, and more importantly, if, legislative leaders within both parties understood limits and opportunities within financial production.

Chapter 3: The Virtue of Liquid Buildings: The Savings and Loan Crisis of 1986 and the Financial Production of Real Estate

The S&L Crisis consisted of the failure of almost one third of the savings and loans associations in the late 1980s. These institutions were understood as the cornerstone to the postwar political economy, creating opportunities for Americans to receive affordable mortgages and home ownership. Beginning in the 1980s, finance capitalism fundamentally transformed the housing market by using mortgages to spur financial growth, despite the underlying “real” growth of the market to be slow or non-existent. These changes touch on the complexity of deregulation in the post-Volcker Shock world, as Regulation Q, a New Deal law limiting the interest rate offered by S&Ls to five percent began to destroy the industry. However, necessary regulatory reform created the groundwork for the transformation of small savings banks into highly speculative financial institutions.

Chapter 4: Producing a Financial Future

This chapter traces the creation of financial futures in the Chicago exchanges. In the 1970s, the newly elected head of the Chicago Mercantile Exchange, Leo Melamed, began to transform how futures exchanges operated. Moving beyond agriculture, Melamed created new products that focused on global currency exchanges, and then the S&P 500 Index. Financial

futures quickly became a booming industry, illustrating how financial production replaced heavy manufacturing as the prime sector for American economic growth.

These new products transformed the marketplace. The distance between the material world of actual goods and the imagined world of future goods almost completely dissolved. Commodities that you had to truck, carry, or barter, such as wheat, were transformed into bundled derivatives that speculated on the future value of Wall Street itself. Congress, recognizing the need to support the source of this new wealth creation, remade century-old laws

Chapter 5: The Crash of 1987 and The Golden Egg of Financial Production

The Crash of 1987 was massive. American stock markets suffered one of its largest declines in history, with the S&P 500 alone losing almost 30 percent of its value over five days in October 1987. The total loss of wealth over that period was approximately \$1 trillion.⁶ Despite these astounding figures, the Crash of 1987 is seen as a mere blip on the radar of massive financial growth. A close analysis of the cause, and congressional response to, the calamity illustrates how financial production creates wealth, how this wealth creation is vulnerable to sudden collapses, and how the federal government responded to disaster.

The Federal Reserve and congressional response to the events of 1987 exemplify the solidification of the financier as the new virtuous producer. Greenspan attacked the panic aggressively, issuing public statements confirming the Federal Reserve's commitment to stabilizing the markets, and adjusting interest rates downwards. This movement, while necessary, created a "moral hazard"—traders began to understand that the Federal Reserve would bail them out of risky almost any venture, no matter the cost. Congress mostly ignored the arguments of Reagan's handpicked investigator, Nicholas Brady, to reform and regulate the financial industry.

⁶ "Report of the Presidential Task Force on Market Mechanisms: Submitted to The President of the United States, The Secretary of the Treasury, and The Chairman of the Federal Reserve Board" (1988), <https://archive.org/details/reportofpresiden01unit>.

Instead, Congress agreed with Leo Melamed that any limitation on the American financial markets would effectively kill the “golden egg” of financial production, creating a dynamic mirroring deindustrialization where foreign markets would simply replace the Chicago and New York exchanges. By 1987, financiers, like Leo Melamed, were recognized as the center of the economy, and thus must be protected by state action. Financiers were, in short, the new virtuous producers of wealth.

Epilogue: Country on FIRE

The epilogue briefly explores how the paradigm of the financial virtuous producer continued to frame the political economy for decades to come. The continued development of derivatives and impact of new technology on the NYSE and Chicago futures markets created enormous economic growth in the 1990s and beyond. However, this growth was still marked with fragility as demonstrated in the Dot.com bubble, and of course, the financial crisis of 2007/8.

The events of 2007/8, however, mark more than an economic collapse. It was end of the of the financier is the unquestioned virtuous producer in American society. Popular protest, from the Occupy movement, to the rise of Donald Trump and Bernie Sanders, illustrate how Americans are, once again, searching for answers to how to best make the economy work for everyone. However, there is hope within the chaos. Financial production offers a path to economic equality. The trick is to figure out, once again, how to deem all working Americans—no matter their gender or race—as virtuous producers. Including service work into this cultural ideal is an important mission of our era. Then speculation can be used for good, creating the framework for direct investment into the lives of everyday Americans, connecting the unlimited growth potential of financial production to the general welfare of the public.

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Before arriving at the University of Chicago, I was a full-time employee at Tulane University who decided to take a few history classes for fun. The first class I took was led by Professor Thomas Adams. Professor Adams quickly became my benefactor within Tulane and after. He helped me to enroll as a graduate student at Tulane while working full-time, guided my research, and introduced me to the other members of my Master's Thesis committee, Jana Lipman Michael Bernstein, and Randy Sparks. He also encouraged me to apply to the University of Chicago. Without his generous support I would not be writing these words today. Professor Jana Lipman eagerly took me under her wing and became my thesis advisor at Tulane. She never saw me as a part-time student. Instead, she treated me as any other graduate student, demanding rigor from my research while also offering unparalleled guidance. Professor Michael Bernstein was instrumental to my understanding of capitalism. He graciously took time away from his position as Provost to meet with me to discuss Smith, Marx, Keynes, and Polanyi, while also

guiding my first small steps into the history of capitalism. Finally, Professor Randy Sparks was instrumental to my understanding of the history of New Orleans, which became the bedrock of my MA Thesis. Most of all, I would like to thank my manager within Tulane's Law and Publication Department, Lynn Becnel. Her unceasing support for me through my time as an employee was instrumental to my return to academic life. She never prevented me from attending classes, even during the normal work day. The world would be a much better place if workplaces were staffed with people like Lynn Becnel.

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Introduction

Country on FIRE: The Virtuous Producer in the Era of Finance Capitalism

The Moment of Rupture

On the twenty-first day of 1985, Ronald Reagan declared victory. “Four years ago, I spoke to you of a New Beginning, and we have accomplished that.”¹ This “New Beginning” promised to “Make America Great Again” by restoring “[i]dle industries [that] have cast workers into unemployment, human misery, and personal indignity.”² He promised all Americans the opportunity to “share in the productive work of this ‘new beginning’” and to “share in the bounty of a revived economy.”³

Beginning in 1983, what would be the longest continual period of peacetime economic expansion ever recorded to that point in American history gave substance to Reagan’s second inaugural claim.⁴ As the economy grew, unemployment began to fall. The “Reagan Revolution” wrought the “Reagan Recovery.” The next year’s landslide presidential victory confirmed that millions of Americans agreed with Reagan’s 1982 statement that “there really is something magic about the marketplace when it’s free to operate.”⁵ It would only be a matter of time before America was great again with humming factories full of working men producing modern machines.

¹ Ronald Reagan, “Second Inaugural Address,” (speech, Washington, DC, January 21, 1985), University of California Santa Barbara American Presidency Project, <https://www.presidency.ucsb.edu/documents/inaugural-address-10>.

² Ronald Reagan, “Inaugural Address,” (speech, Washington, DC, January 20, 1981), University of California Santa Barbara American Presidency Project, <http://www.presidency.ucsb.edu/ws/?pid=43130>.

³ Reagan, “Inaugural Address,” (speech, Washington, DC, January 20, 1981).

⁴ Sean Wilentz, *The Age of Reagan: A History 1974-2008* (Harper Perennial, 2008), 170. The economic expansion between 1991-2001 and 2009-2020. See “Business Cycle Dating Committee Announcement June 8, 2020,” National Bureau of Economic Research, June 8, 2020, <https://www.nber.org/news/business-cycle-dating-committee-announcement-june-8-2020>.

⁵ Ronald Reagan, “Radio Address to the Nation on Taxes, Tuition Tax Credit, and Interest Rates,” April 24, 1982, at John Woolley and Gerhard Peters, *The American Presidency Project* (online), Santa Barbara: University of California, <http://www.presidency.ucsb.edu.ws>.

This, however, was not the story of Reagan’s second term. Finance, not industrial manufacturing, became the center of American wealth creation. Throughout the decade, as measured by total corporate profits, manufacturing fell from 35 percent to 17 percent as finance, insurance, and real estate (abbreviated as FIRE industries) grew from 17 percent to 35 percent. By the year 2000, manufacturing had nosedived to an all-time low of 10 percent, while FIRE maintained an ever upward trajectory at 45 percent (and climbing). This dramatic rise of the total profit share of FIRE industries between 1980 and 2000 defines finance capitalism.⁶

Despite this transformation, Americans—from policy makers to everyday citizens—continued to use industrial-era ideals to frame and understand the economic problems of the era. Hollywood actresses swayed the American public to subsidize farmers in order to prevent the “last remnants of our great cultural heritage [from] disappear[ing].”⁷ Conservative politicians argued that tax cuts and monetary policy aimed at depreciation would rebuild American heavy industry.⁸ Yet, finance capitalism grew. The savings and loan industry pushed for deregulation that transformed the once stable home mortgage industry into the site of extreme financial speculation. New advancements in computational algorithms transformed the futures market from a century-old model based on agricultural production to one based on the future growth of the financial industry itself.⁹ However, the paradigm of the industrial economy continued to influence this moment of fundamental economic change. Why did this happen? What was it about the old political-economic paradigm that prevented sober assessment of the new financial capitalism?

⁶ Greta R. Krippner, *Capitalizing on Crisis: The Political Origins of the Rise of Finance* (Harvard University Press, 2011), 27-57, Figure 1, 31, Figure 3, 33, Figure 7, 39.

⁷ Jessica Lange, Live Aid Broadcast, September 22, 1985.

⁸ Rep. Gingrich, H. 10808, 99th Cong., 1st sess., *Congressional Record* 131 (December 4, 1985); Ronald Reagan, “Remarks to Employees of the Department of the Treasury,” February 5, 1986, *Ronald Reagan Presidential Library* (online), <https://www.reaganlibrary.gov/research/speeches/20586e>.

⁹ Diana B. Henriques, *A First-Class Catastrophe: The Road to Black Monday, The Worst Day in Wall Street History* (Henry Holt & Co., 2017).

Virtuous Production in the age of Finance Capital

In this dissertation, I examine how congressional and private sector decision makers of the 1980s understood financial production, and how this understanding shaped policy. The years between 1980 and 2008 have been defined as the “Neoliberal Order.”¹⁰ My analysis does not challenge this categorization. However, I aim to refocus the point of rupture from political to economic—from the election of Ronald Reagan to the Volcker Shock. The current literature centers the election of Reagan as the realization of this new era. This framework has merit. Reagan’s election, after all, ushered in free market reforms— principally deregulation, anti-union sentiment, and austerity politics—that have defined U.S. political economy for over forty years. However, I contend that the center of this change rests within the dramatic reshaping of the economic order. Financialization remade how the economy functioned, constraining what was previously thought possible while also creating unintended consequences to political decision making.¹¹

Placing this dramatic economic shift, rather than political, at the center of rupture opens a new path of analysis. Primarily, this project illuminates how confused, chaotic, and contingent the transformation of the political economy during the 1980s was. Despite the perceived success of the Reagan Revolution, the chapters ahead illustrate how there truly was no master plan.

Important legislative actions, from tax reform to deregulating the savings and loan industry, were

¹⁰ Gary Gerstle, *The Rise and Fall of the Neoliberal Order: America and the World in the Free Market Era* (Oxford University Press, 2022).

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reactions to quickly changing circumstances that were beyond the direct control—and most importantly, the understanding—of decision makers. Legislation often aimed to use the power of the of the federal state to save pillars of the postwar era. Farmers, industrial manufacturers, and affordable mortgages all were the focus of major congressional action. But these actions only furthered the transition to a financialized economy, and did very little to help target constituents. Despite the chaos, a new logic emerged: financiers were recognized as wealth creators, who gave new life to the moribund economy, leading the way for economic growth and prosperity into the coming decades.

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Rather than the overwhelming success of the Reagan Revolution and democratic acquiescence to the magic of the free market, the virtuous producer narrative remained the driving force behind political economic decision making. I argue that the financier replaced the industrial laborer in the 1980s. The complex transition to financial economy followed the older model of industrial production that remained authoritative to congressional decision makers throughout the early and mid-1980s. It was only after a series of unintended consequences of policy—tax reform, real estate expansion, and most importantly, the Wall Street Crash of 1987—that financiers became the key producers in the new economy, thus meriting support by the state.

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¹³ Steve Fraser and Gary Gerstle, eds., *The Rise and Fall of the New Deal Order, 1930-1980*, (Princeton University Press, 1989).

¹⁴ Greta R. Krippner, *Capitalizing on Crisis: The Political Origins of the Rise of Finance* (Harvard University Press, 2011); James K. Galbraith, *The End of Normal: The Great Crisis and the Future of Growth* (Simon & Schuster, 2014).

wisdom emerged from an era defined by chaos and misunderstanding. The virtuous producer remained at the heart of the American political economy.

Old Ideals in a New Economy

The material and cultural effects of production at the nation's founding worked in unison to create America's distinct political economy centered on the ideology of virtuous production. The Founders could be described as nervous revolutionaries. Up to that point, history only provided examples of failed republics—often, as they understood, at the hands of moral degradation that ultimately lead to tyranny. Consequently, the many Founders believed that democratic polity required popular virtue for its stability and success. The people, according to the Constitution, would enact and carry out the law. Therefore, the people themselves must be moral and virtuous to ensure the implementation and continuation of the constitutional form of government that the Founders had conceived. Furthermore, the Founders, mirroring Adam Smith, did not separate economics from ethics. In fact, the two were intertwined. Just how people interacted within the confines of the broadly understood market directly affected their social and political interactions.¹⁵ Economic relations, accordingly, must also inhabit the virtuous republican social values.¹⁶

The question of the age was how to promote an ideal economic actor who represented the values of the republic. This man—only men could vote—was someone who remained independent from the influence of malignant forces, maintained an inner morality, and whose

¹⁵ Adam Smith, D. D. Raphael, and A. L. Macfie, *The Theory of Moral Sentiments* (1759; Liberty Classics, 1982); Adam Smith, *The Wealth of Nations, Books I-III* (1776; Penguin Books, 1999).

¹⁶ Joyce Appleby, *Capitalism and a New Social Order: The Republican Vision of the 1790s* (New York University Press, 1984); Christopher Clark, "The Agrarian Context of American Capitalist Development," *Capitalism Takes Command: The Social Transformation of Nineteenth-Century America*, Michael Zakim & Gary Kornblith eds. (University of Chicago Press, 2012), 35-37; Drew R. McCoy, *The Elusive Republic: Political Economy in Jeffersonian America* (University of North Carolina Press, 1980).

work was recognized to be beneficial to the common good over private gain. For Thomas Jefferson and his acolytes, the answer was found in the humble wheat farmer. These farmers—imagined as men—embodied the republican vision in two key ways. First, success of the republican government would be guaranteed by these citizens because personal autonomy arose from ownership of productive property, creating “substantial and genuine virtue,” where self-interest could be subordinated for the public good. Unlike a wage laborer, whose dependence on another for earnings “begets subservience and venality, suffocates the germ of virtue, and prepares fit tools for the designs of ambition,” the farmer remained independent, reliant only on his own land to provide for his family.¹⁷

Secondly, what these farmers produced was essential to establishing a successful, moral republic. Unlike cash crops of sugar and tobacco, wheat was not a morally degrading luxury. Instead, wheat was a staple good that fed the men and women the world over. In the image of the wheat farmer, we can fully understand the formation of the virtuous production ideal. Independent from the sway of others, these farmers used their own property to produce a profitable commodity that tended to the common good of all.¹⁸

Of course, the nation did not become a land of independent wheat farmers. Between 1790 and 1800 (the same decade that the Jeffersonian vision took shape), coastal cities—New York, Philadelphia, and Baltimore—rapidly grew in population.¹⁹ A new query emerged as an ever-increasing number of men became laborers within these rapidly expanding cities: how can

¹⁷ Thomas Jefferson, “Query XIX: The Present State of Manufacturers, Commerce, Interior and Exterior Trade?,” *Notes on the State of Virginia*, reprinted in *Jefferson: Writings* (The Library of America, 1984), 290-91.

¹⁸ Appleby, *Capitalism and a New Social Order*, 42-46.

¹⁹ Sean Wilentz, *Chants Democratic: New York City and the Rise of the American Working Class, 1788-1850* (Oxford University Press, 1984), 25. New York City increased in population by more than 80 percent between 1790-1800.

Jeffersonian ideal of propertied independence apply to wage labor? This conundrum would shape the American political economy of the nineteenth century.

In the early nineteenth century, male laborers challenged aspects of the Jeffersonian Ideal. Primarily, they sought to transform the landed property ethos that defined economic dependence as contrary to freedom. Inspired by Ricardian economics that recognized labor as the source of all wealth, workers across the country sought to remake the conception of labor. Although they were dependent on others for wages, the work they did—their labor—created the nation’s wealth. Their labor, then, was an essential commodity in the marketplace. Because they controlled their own labor, they in essence owned this precious commodity—labor became a type of property that every working man owned. Paralleling farmers’ landownership, these laborers—through the power of contract—could choose how, when, and at what cost they could sell their own labor. This “free soil” ideal effectively spread the republican ideal of political virtue through property ownership beyond the narrow confines of land ownership to the growing masses of wage laborers.²⁰

As the nineteenth century progressed, labor and production became increasingly important to maintaining the ideal of a republican democracy in the face of industrial capitalism. In the antebellum period, free labor ideology made men’s labor a type of property. Despite this mental maneuver, there remained an evergreen optimism that waged labor was a mere waypoint on the road to buying land to farm.²¹

²⁰ Amy Dru Stanley, *From Bondage to Contract: Wage Labor, Marriage, and the Market in the Age of Slave Emancipation* (Cambridge University Press, 1998); Eric Foner, *Free Soil, Free Labor, Free Men: The Ideology of the Republican Party before the Civil War* (Oxford University Press, 1995).

²¹ Daniel T. Rodgers, *The Work Ethic in Industrial America, 1850-1920* (University of Chicago Press, 1978). According to Daniel Rodgers, after the Civil War, production was vital to the American work ethic. As the country industrialized through the nineteenth century, the work of economically independent tradesmen and mechanics shifted into forms of wage work that closely resembled indentured servitude. In order to maintain the “façade” of individuality, in terms of both success and creativity, meaningful work was tied to the production of products that enrich the lives of your fellow Americans.

By the late nineteenth century, it became impossible to contend that wage labor was only a temporary condition. Again, paralleling the archetype of the Jeffersonian farmer, men's labor maintained that work and production were essential to maintaining a successful, moral republic. Although they would be forced to sell their labor-commodity in perpetuity, wage-earners would be redeemed by what they literally worked to produce. Thus, an ethic of virtuous work was tied to the production of goods that enrich the lives of your fellow Americans. A virtuous and moral American was not just a wheat farmer who produced the food that fed the world—but also the smelter of steel that made modern cities, the line worker who formed machines of progress, and the miner who helped fuel America's westward expansion.²²

The New Deal Order

The ideal of virtuous production, gestating since the founding, reached its pinnacle during the mid-twentieth century New Deal Order. As defined by Gary Gerstle, “order” is a term that allows historians to encompass culture, ideology, and political economy to describe a hegemonic power structure of relations.²³ During this epoch, federal decision making, economic orthodoxy, and popular understanding all coalesced to create a type of conventional wisdom that laissez faire capitalism was destructive to society and needed to be tamed by the state. Public good was

²² Michael Zakim & Gary Kornblith eds., *Capitalism Takes Command: The Social Transformation of Nineteenth-Century America*, (University of Chicago Press, 2012), 35-37; Eric Foner, *Free Soil, Free Labor, Free Men: The Ideology of the Republican Party before the Civil War* (Oxford University Press, 1995); Jonathan Levy, *Freaks of Fortune: The Emerging World of Capitalism and Risk in America* (Harvard University Press, 2012); Gunther Peck, *Reinventing Free Labor: Padrones and Immigrant Workers in the North American West, 1880-1930* (Cambridge University Press, 2000).

²³ Gerstle, *The Rise and Fall of the Neoliberal Order*, 2.

tethered to a moral perspective that kept capital in check. Central to this process was the idealized white male industrial laborer.²⁴

In the 1940s, the American factory worker was cast as the virtuous producer of the “arsenal of democracy.” Tanks, guns, airplanes—all manufactured by American factory workers—were used to defeat fascism, thus making the world safe for democracy.²⁵ After World War II, manufacturing was converted from armament to peacetime production—refrigerators replaced mortars. Producing and consuming these goods became a way for normal Americans to combat the subversive Soviet threat of “collectivism.” The American household, abundant with consumable goods ranging from coffee makers to General Motor’s sedans, created “record levels of employment” and guided “the nation from the potential ‘chaos of peace’ to ‘a safe and stable postwar position.’” The fully-stocked home, made possible by American manufacturing, represented the ability of democracy and capitalism to provide meaningful work, economic equality, and material abundance for all Americans.²⁶

It is impossible to overstate the importance of this epoch. The end of the war brought to fruition Henry Luce’s bombastic proclamation of the “American Century.”²⁷ Despite initial fears, manufacturing effectively transferred from a wartime to a peacetime economy. The U.S. commanded one half of the world’s manufacturing capacity; a fact reflected in the 1955 inaugural list of the Fortune 500 that was topped by General Motors, Ford, U.S. Steel, and Chrysler. Congruently, the United States held approximately 70 percent of the global gold

²⁴ Steve Fraser and Gary Gerstle, eds., *The Rise and Fall of the New Deal Order, 1930-1980*, (Princeton University Press, 1989); Lizabeth Cohen, *Making a New Deal: Industrial Workers in Chicago, 1919-1939* (Cambridge University Press, 1990).

²⁵ James T. Sparrow, *Warfare State: World War II Americans and the Age of Big Government* (Oxford university Press, 2011); Paul A. C. Koistinen, *Arsenal of World War II: The Political Economy of American Warfare, 1940-1945* (Lawrence: University Press of Kansas, 2004); Vernon W. Ruttan, *Is War Necessary for Economic Growth?: Military Procurement and Technology Development* (New York: Oxford University Press, 2006).

²⁶ As illustrated by the famed “Kitchen Table Debates” between Nixon and Khrushchev in 1959. Lizabeth Cohen, *A Consumers’ Republic: The Politics of Mass Consumption in Postwar America* (Vintage Press, 2003), 126.

²⁷ Henry Luce, “The American Century,” *Life Magazine* (February 1941).

reserves. Depression and world war fundamentally altered the U.S. state's role in the economy as full employment became the mantra of the postwar moment.²⁸

The heart of the New Deal order was a focus on the demand side of the economy. Previously, policy emphasized the supply side: encouragement of saving and investment, focused development of specific sectors—in short, capital.²⁹ It is not as if the federal government ceased to help capital throughout the New Deal era.³⁰ However, the new political economy that centered on demand promoted consumption, and thus, higher wages, in order to stabilize the economy.³¹ The following three decades brought successful investment in illiquid capital—in the form of industrial manufacturing plants—that redistributed wealth through incomes, high taxation, and public spending as never before seen in American history. This dynamic resulted in wages rising nearly 200 percent for the bottom 90 percent of earners between 1940 and 1970.³²

The federal government's move to protect the era's virtuous producer made the new Deal paradigm possible. Beginning with the Wagner Act, the federal government moved to protect the power of industrial labor—thus the demand side of the economy—in order to secure economic stability. By 1950, the “Treaty of Detroit” marked the acceptance by capital to accept collective bargaining and organized labor in mass production industries, allowing wage increases and

²⁸ Robert J. Gordon, *The Rise and Fall of American Growth* (Princeton University Press, 2016), 329-532; Robert M. Collins, *More: The Politics of Economic Growth in Postwar America* (Oxford University Press, 2000); Bruce Cumings, *Dominion from Sea to Sea: Pacific Ascendancy and American Power* (Yale University Press, 2009).

²⁹ Naomi R. Lamoreaux and William J. Novak, eds., *Corporations and American Democracy* (Harvard University Press, 2017); Jonathan Levy, “Book Two: The Age of Capital, 1860-1932,” in *Ages of American Capitalism: A History of the United States* (Random House, 2021), 189-390.

³⁰ Mark R. Wilson, *Destructive Creation: American Business and the Winning of World War II* (University of Pennsylvania Press, 2016).

³¹ John Kenneth Galbraith, “How Keynes Came to America,” in John Kenneth Galbraith, *The Essential Galbraith*, Andrea D. Campbell, ed. (1971; Houghton Mifflin, 2001), 236-48; Meg Jacobs, *Pocketbook Politics: Economic Citizenship in Twentieth Century America* (Princeton University Press, 2004).

³² Peter H. Lindert and Jeffrey G. Williamson, *Unequal Gains: American Growth and Inequality Since 1700* (Princeton University Press, 2016); NPR, “The Fall and Rise of U.S. Inequality, In 2 Graphs, NPR.org, Last modified February 11, 2015, <http://www.npr.org/blogs/money/2015/02/11/384988128/the-fall-and-rise-of-u-s-inequality-in-2-graphs>; Stephen Kemp Bailey, *Congress Makes a Law: The Story Behind the Employment Act of 1946* (Columbia University Press, 1950); Cohen, *A Consumers' Republic*.

benefits (such as employer funded health care and pensions).³³ In return, labor abandoned demands for co-management and helped purge the socialist and communist left from its ranks.³⁴ Although Alan Brinkley cogently argues that the post-1937 move to protect a consumer-based economy ended any attempt to truly reform capitalism, the transformation of industrial labor from a dangerous, underpaid job to a marquee form of American employment was fundamental for the growth of the middle class.³⁵ Economic growth, centered on the industrial virtuous producer, remained the paramount goal of the political economy for the next forty years.³⁶

The New Deal era, however, did not bring equality to the country. Ira Katznelson demonstrates the racist structure of legislation that defined the era. The aptly named “southern cage,” a powerful bloc of southern congressional representatives, voted in lock-step to ensure that the Wagner Act only protected industrial labor, which was mostly centered in the north. Southern labor regimes of agricultural and service work that relied on an apartheid governance to control Black labor remained untouched. This both kept federal oversight beyond the reach for a vast majority of laborers in the region, and reinforced racialized view of the virtuous producer as a white man. Furthermore, when FDR attempted to attend to this failure with the Fair Labor & Standards Act (FLSA), legislation that applied the same protection to all federally employed laborers, no matter their race, southern congressmen revolted. The resulting Dixiecrat movement joined Republican members in support of the Taft-Hartley bill, effectively ending major labor reform efforts in the era.³⁷ The attempt to include minority labor within the virtuous producer

³³ Nelson Lichtenstein, *The Most Dangerous Man In Detroit: Walter Reuther And The Fate Of American Labor* (Basic Books, 1995).

³⁴ Ellen Schrecker, *Many are the Crimes: McCarthyism in America* (Little, Brown and Company, 1988).

³⁵ Alan Brinkley, *The End of Reform: New Deal Liberalism in Recession and War* (Vintage books, 1995).

³⁶ Collins, *More: Cohen, A Consumers' Republic*; Cowie, *The Great Exception*.

³⁷ Barbara S. Griffith, *The Crisis of American Labor: Operation Dixie and the Defeat of the CIO* (Temple University Press, 1988).

construct sparked a political realignment that would come to define the end of the twentieth century.³⁸

The virtuous producer ideal was used to uphold centuries-old cultural ideals centered on coverture, sexual, and racialized differences, all of which made the white-male industrial manufacturer the centerpiece of the New Deal Order. Immigration, the Lavender Scare, red lining, and of course the Red Scare, all illustrate how race, gender, sexual, and political identity shaped governmental policies and the boundaries of full citizenship. Despite increasing numbers of women in the workforce, the ideal of a male breadwinner providing for his family, and a female homemaker supporting her husband's "productive" wages labor with her own unpaid household labor, remained central to the postwar political economy. Similarly, attitudes towards racial difference—used to deflate minority wages and access to promotion and other forms of capital investment—remained dominant to creating wealth through access to unionized employment, suburbanized home ownership, and voting rights. Taken as a whole, the New Deal Order represents a continuation of fundamental economic and political inequality that reinforced white supremacy through the white male breadwinner ideal.³⁹

Ironically, beneficiaries from this political economy began to mount a strident countermovement. Emerging from newly affluent suburbs, such as Orange County, California, a renewed conservative ideology began to question the role of the federal government in society. Motivated by a Cold War mindset that held a deep distrust of government regulation—unless of

³⁸ Nelson Lichtenstein, *A Contest of Ideas: Capital, Politics, and Labor* (University of Illinois Press, 2013); Angie Maxwell and Todd Shields, *The Long Southern Strategy: How Chasing White Voters in the South Changed American Politics* (Oxford University Press, 2019).

³⁹ Margot Canaday, *The Straight State: Sexuality and Citizenship in Twentieth-Century America* (Princeton University Press, 2009); Mae M. Ngai, *Impossible Subjects: Illegal Aliens and the Making of Modern America* (Princeton University Press, 2004); Elaine Tyler May, *Homeward Bound: American Families in the Cold War Era* (Basic books, 1988, 1999); Thomas J. Sugrue, *The Origins of the Urban Crisis: Race and Inequality in Postwar Detroit* (Princeton University Press, 1996, 2005); Richard Rothstein, *The Color of Law: A Forgotten History of How Our Government Segregated America* (Liveright Publishing, 2017); Judith Stein, *Running Steel, Running America: Race, Economic Policy, and the Decline of Liberalism* (University of North Carolina Press, 1998)..

course, it benefited their own framing of the virtuous producer—these Americans argued that federal involvement in a multitude of matters from supporting basic civil rights to environmental health, constituted an attack on an idealized form of liberty. Perhaps most thought-provoking, as Lisa McGirr argues, is that the “cultural criticisms” of these conservatives “responded to the discontents created by the dynamics of capitalism.” Postwar industrial capitalism fueled the growth of large-scale institutions that concentrated economic and political power to urban centers. This centralized power incited change and innovation that undermined locality, community, and family authority. Nevertheless, a belief that free markets best provided the path to continued prosperity and virtue undergirded their continued support for an idealized form of laissez-faire capitalism that, according to their belief, the New Deal Order ended.⁴⁰

Congruently, think tanks, academic theory, and political action groups, supported by business elites, economists, and intellectuals, turned critique of the New Deal Order in to political action. Business elites never fully accepted the dynamics of the Treaty of Detroit, and soon mounted a sustained effort to limit the expansion of labor protections and control over internal investment decisions. Again, the Cold War played a critical role, creating an opportunity to cast the “free enterprise system” as the vanguard for American prosperity and democratic freedom, placing the long shadow of the failure of capitalism in 1929 to the dustbin of history. Economic theorists, famously Milton Friedman and Friedrich Hayek, put their intellectual theories to paper. Arguing that government cannot possibly understand, yet alone control, the

⁴⁰ Lisa McGirr, *Suburban Warriors: The Origins of the New American Right* (Princeton University Press, 2001), 163; Michelle M. Nickerson, *Mothers of Conservatism: Women and the Postwar Right* (Princeton University Press, 2012); Matthew Lassiter, *The Silent Majority: Suburban Politics in the Sunbelt South* (Princeton University Press, 2006); Robert O. Self, *All in the Family: The Realignment of American Democracy Since the 1960s* (Hing and Wang, 2012); Dan T. Carter, *The Politics of Rage: George Wallace, The Origins of the New Conservatism, and the Transformation of American Politics* (Simon & Schuster, 1995).

complex dynamics of capital flow, a new line of free market economic thought emerged from the Swiss resort of Mont Pelerin to find a home at the University of Chicago.⁴¹

Throughout the 1960s and 1970s, these two movements began to coalesce behind political firebrands of Barry Goldwater, and eventually, Ronald Reagan. Ideas promoted both by grassroots and monied conservative interests gained traction within the polity, especially with white suburbia as the country's mounting social and economic woes chipped away at the promise of equality through growth central the New deal Order. By the late 1970s, Americans were searching for new answers to solve the malaise of the decade. Then, in 1979, a shock hit the system that fundamentally transformed both the American economy and politics.⁴²

Financialization

Financialization was more than just a shift from one economic system to another, from industrial production to financial production. It was a fundamental restructuring in how work, society, and the economy—in short, capitalism—functioned. Cultural, social, and political values were all affected by, and affected, this change. The pages ahead analyze how the preceding cultural and social values that were shaped by 200 years of agricultural and industrial production shaped the political economy of financialization throughout the 1980s. The result was a new political-economic ideology, broadly shared across the political spectrum, which fit the dramatic changes of a financially-fueled economy into older conceptions of American ideals surrounding a virtuous work ethic.

⁴¹ Philip Mirowski & Dieter Plehwe eds., *The Road from Mont Pelerin: The Making of the Neoliberal Thought Collective* (Harvard University Press, 2009); Angus Burgin, *The Great Persuasion: Reinventing Free Markets since the Depression* (Harvard University Press, 2012).

⁴² Jefferson Cowie, *Stayin Alive: The 1970s and the Last Days of the Working Class* (The New Press, 2012); Judith Stein, *Pivotal Decade: How the United States Traded Factories for Finance in the Seventies* (Yale University Press, 2010); Niall Ferguson, Charles S. Maier, Erez Manela, and Daniel Sargent, eds., *The Shock of the Global: The 1970s in Perspective* (Harvard University Press, 2010).

The Volcker Shock ushered in a new type of capitalism. The event itself is rather easily explained. In order to slay the dragon of inflation that had been “eating at our innards” for almost a decade, newly minted Chairmen of the Federal Reserve, Paul Volcker, allowed interest rates to rise to unprecedented levels.⁴³ Throughout the New Deal Order, the Fed constantly managed the supply side of the economy by indirectly adjusting the quantity of money through short-term interest rates. Raising or lowering the interest rate either made loans more expensive, thus limiting the flow of capital, or cheaper, increasing capital flow. The underlying theory held that less money in circulation countered inflation, but brought recession and high unemployment; conversely, low interest rates spurred investment, creating new business and employment opportunities, but risked overheating into inflationary periods.⁴⁴

On October 6, 1979, Volcker implemented a monetarist policy that aimed to limit the money supply. Interest rates spiked at 20 percent in 1981, resulting in the highest rate of unemployment (10.8 percent) since the Great Depression. While the shock effectively ended the inflation crisis of the 1970s, it had a plethora of unintended consequences. Primarily, the U.S. bond market became a hotbed of international investment. Seeking high returns, global investment poured in. Investment did not end when interest rates were lowered. Instead, capital pools seeking continued high returns switched from the bond to stock market, creating a never-ending credit supply to the U.S. financial marketplace.⁴⁵

This event had immediate political ramifications as high rising unemployment propelled Reagan to electoral victory in 1980. Although historians have expertly revealed how

⁴³ “Interview with Paul Volcker,” *Commanding Heights*, September 26, 2000, PBS.org, available at http://www.pbs.org/wgbh/commandingheights/shared/minitext/int_paulvolcker.html.

⁴⁴ Michael Bernstein, *A Perilous Progress: Economists and Public Purpose in Twentieth Century America* (Princeton University Press, 2001).

⁴⁵ Krippner, *Capitalizing on Crisis*; Levy, “Book Four: The Age of Chaos,” in *Ages of American Capitalism*, 587-732.

globalization and economic changes combined with shifting social dynamics in postwar America to create an “Age of Fracture” that resulted in the “Reagan Revolution,” a more profound story has been neglected. Unlike previous financial expansions, liquid capital was not reinvested back into industrial production. During the Great Merger Movement of the 1890s, investors, like J.P. Morgan, invested in Carnegie’s steelworks, creating U.S. Steel. Again, in the 1920s, the democratization of Wall Street brought mass shareholder investment into new companies, such as General Motors. This did not occur in the 1980s as deindustrialization continued uninterrupted. Instead, capital remained largely liquid and speculative. Even when invested in material things, such as real estate, profits were not realized from actual products, but rather the future value of the good—a building that would be worth more as an asset to borrow against, or to use as a tax write-off, rather than as a space of material productive output.⁴⁶

The historiography of this shift has muddled our understanding of this critical moment. First and foremost, finance capitalism has yet to be fully explored as a distinct type of capitalism. Instead, neoliberalism has been used to account for all aspects of the dramatic economic change of the 1980s. Gary Gerstle’s *The Rise and Fall of the Neoliberal Order* best captures this trend. For Gerstle, the Neoliberal Order replaced the New Deal Order with the landslide election of Ronald Reagan in 1980. Reagan famously proclaimed that government was the problem rather than the solution. Acting upon this mantra, he worked to deregulate industries, crushed organized labor in the Professional Air Traffic Controllers strike of 1981, promoted supply-side economic theory, repealed the FCC’s “fairness doctrine,” and appointed judges who were constitutional “originalists” whose narrow view of interpretations of the Constitution’s commerce clause

⁴⁶ Judith Stein, *Pivotal Decade: How the United States Traded Factories for Finance in the Seventies* (Yale University Press, 2010); Michel Feher, *Rated Agency: Investee Politics in a Speculative Age* (Zone Books, 2018); Maurizio Franzini and Mario Pianta, *Explaining Inequality* (Routledge, 2015); Christian E. Weller, ed., *Inequality, Uncertainty, and Opportunity: The Varied and Growing Role of Finance in Labor Relations* (Cornell University Press, 2015)

continue to limit civil rights of American citizens. Taken together, these actions define the contours of neoliberal policy making.⁴⁷

There is truth to this argument. Reagan's election was a watershed moment in electoral politics. However, as applied to the 1980s, this argumentation gives too much power to too few people with too little understanding of the broad economic shift at hand. Ronald Reagan did not have an authoritarian hand to shape either politics or the economy. He and his advisors were constantly hemmed in by events and counter arguments. The history of neoliberalism elides these facts. Instead, scholars apply the term to "everything from architecture, film, and feminism to the politics of both Donald Trump and Hillary Clinton"—to the point where the word itself has become meaningless.⁴⁸

Recently, scholars have turned their attention to more specific policy decisions of the period. Foremost among these works is Greta Krippner's *Capitalizing on Crisis*. In this careful study, Krippner lays bare that the financialization of the economy was not due to magic of the markets, but rather the unintended consequences of Paul Volcker. Specifically, in the early 1980s, "policymakers had not fully adjusted to the thinking of the world in terms of a sea of capital flows." Thus, when Volcker let the market decide on interest rates as high as 20 percent, none of Reagan's "close advisors had anticipated the role that foreign capital flows would come to play in financing the budget deficits"—let alone the economy as a whole.⁴⁹

Monica Prasad's latest work, *Starving the Beast: Ronald Reagan and the Tax Cut Revolution* adeptly explains how tax cuts became central to the Republican Party's political

⁴⁷ Gerstle, *The Rise and Fall of the Neoliberal Order*; Joseph McCartin, *Collision Course: Ronald Reagan, the Air Traffic Controllers, and the Strike that Changed America* (Oxford University Press, 2013); Rodgers, *Age of Fracture*; Jones, *Masters of the Universe*; Nicole Hemmer, *Partisans: The Conservative Revolutionaries Who Remade American Politics in the 1990s* (Basic Books, 2022).

⁴⁸ Daniel Rodgers, "The Uses and Abuses of 'Neoliberalism,'" *Dissent* (Winter 2018), <https://www.dissentmagazine.org/article/uses-and-abuses-neoliberalism-debate>.

⁴⁹ Krippner, *Capitalizing on Crisis*, 94-95.

ideology. Perhaps more importantly, she shows that business leaders were hesitant to embrace this new model. It was only after years of persuasive effort by Republican Congressman Jack Kemp and other supply-side champions that business leadership agreed to support the new Republican low-tax agenda.⁵⁰

Gabriel Winant's *The Next Shift: The Fall of Industry and the Rise of Health Care in Rust Belt America* investigates the rise of the service economy in the American Rustbelt. Caregivers—historically roles filled by women and people of color—were excluded from protections of the New Deal state. However, these workers fulfilled important roles supporting the white male breadwinner in industrial cities. So much so that the economic security of the postwar Fordist era was structurally premised on these marginalized workers. Winant then explains how during the 1970s and 1980s, deindustrialization caused both a contraction in industrial labor, but also led to an expansion in the health care industry. As healthcare replaced industry, women nurses caring for retired male manufacturing workers became the new breadwinner for households throughout the Rustbelt. However, the same structure that marginalized service workers throughout the postwar era remained in place, fueling contemporary inequality. This dynamic is explicitly illustrated by the largest employer in Pittsburgh, University of Pittsburgh Medical Center. Where U.S. Steel once offered unionized pay with pension funds, the University of Pittsburgh Medical Center provides poverty wages and unsustainable working conditions.⁵¹

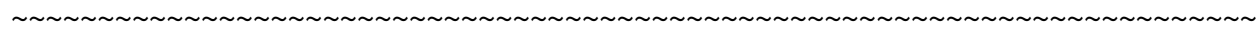
Winant's work offers critical insight into the transformation of the political economy during the 1970s and 1980s that acts as a complementary companion to this dissertation. The rise of the service economy fundamentally transformed the nation. So much so that it was described

⁵⁰ Monica Prasad, *Starving the Beast: Ronald Reagan and the Tax Cut Revolution* (Russel Sage Foundation, 2018).

⁵¹ Gabriel Winant, *The Next Shift: The Fall of Industry and the Rise of Health Care in Rust Belt America* (Harvard University Press, 2021).

as the “most important economic transition since the Industrial Revolution” during testimony before Congress in 1984.⁵² This fear was rooted in the fact that “transformation of America into a ‘service economy’” would create an economy of “low-wage dead-end jobs” leading to “a society increasingly characterized by chronic unemployment, inequality and insecurity.”⁵³ As the words of these expert witnesses show, service work was not considered to be as important as male labor centered on industrial production in the 1980s. Thus, the rise of the service industry could only be imagined as catastrophic precisely because of who was historically employed in those positions. Women and people of color were not recognized as virtuous producers, no matter how essential their labor was to American society. The continued marginalization of service work shaped the Neoliberal Order, creating inequality that was fundamentally rooted in the racial and gendered hierarchy of the New Deal Order.⁵⁴

However, the rise of the service industry alone does not fully explain our current inequality, nor political economy. This dissertation fills this void by focusing on the rise of financial production. Through this lens of analysis, we can understand how cultural values surrounding production not only limited citizens access to government support, but also created the framework necessary for Congress to cast the financier as new the virtuous producer of American society.



⁵² Ronald Shelp, Testimony before the Subcommittee on Economic Stabilization, June 8, 1984. Congress of the United States, *Service Industries: The Future Shape of the American Economy*, 98 Cong., 2nd Sess., June 8, 12, 14, and 28, 1984 (Washington D.C.: U.S. Government Printing Office, 1984), 94.

⁵³ Sarah Kuhn, *Service Industries: The Future Shape of the American Economy*, 585.

⁵⁴ Winant, *The Next Shift*; Thomas Adams, “The Servicing of America: Political Economy and Service Work in Postwar Southern California,” (unpublished dissertation, University of Chicago, 2009).

Structure of Dissertation

The study of the 1980s remains mostly uncharted territory as scholars only recently have attempted to look at the specificity of the era. The fall of the New Deal Order and the rise of the Neoliberal Order both remain tied to an understanding of the Reagan presidency that does not hold up to scrutiny. True, Reagan's first term was marked with significant legislation that had monumental impact. However, by 1985 most of these policies had been proven ineffective. Deregulation and tax cuts did not make America great again as the industrial economy continued to precipitously decline. The free market did not bring stability. Instead, a series of crises hit the nation throughout the mid- to late-1980s. All while inequality grew. Yet, the political economic sea change of this era has defined America for over forty years. How did this happen? This dissertation demonstrates how the ideal of the virtuous producer solidified the new political economy of financial production.

Reagan's second term, not his first, is fundamental to fully understanding the transformation of the era. The Farm Crisis demonstrates the continued importance of the virtuous producer ideal in American thought. The Tax Reform Act of 1986 and the Savings and Loan Crisis both show how cornerstones of the New Deal political economy—from supporting industrial manufacturing to creating affordable mortgages—were fundamentally transformed by the Volcker Shock, and how this transformation affected political decision making. The Wall Street Crash of 1987 represents the marquee moment when Congress recognized financial production as the engine of American economic growth and used its legislative power to protect financiers—the virtuous producers of the new era. The transformation of the virtuous producer from an industrial manufacturer to speculative financier effectively transferred the center of the

political economy from the demand to supply side. This transformation remade American society.

The *Congressional Record* illuminates a national story of change through the impact of federal policy. Congressional action, and inaction, had tremendous impact on how finance capitalism developed in the 1980s. Proceedings within the *Congressional Record* give direct substance to how nubilous ideas centered on the free market and deregulation were implemented into policy. Simultaneously, focusing on the hearings, debates, and even the specific wording of bills surrounding key moments of crisis illuminates not only the political ideas behind policy making, but also avoids theoretical argumentation based on vague neoliberal ideology and the extreme minutiae of daily congressional procedures.

Furthermore, focusing on the role of Congress, rather than the Reagan Presidency, illustrates the complexities of the Reagan Revolution. Though the period is marked by political transformation, there was a genuine spirit of bipartisanship centered on solving problems. Of course, there were partisan vanguards such as Newt Gingrich. However, for the most part, congressional representatives from both parties were eager to govern together and solve problems. However, as I illustrate throughout, most congressional representatives simply did not fully understand how the economy had fundamentally changed. Policy attempting to solve the crises wrought by financialization often only reinforced the growing financialized economy.

Politicians were not solely responsible for the dramatic changes of the 1980s. The era witnessed the dramatic influence of think tanks on policy decisions. For example, Eugene Steuerle became a key figure in the 1986 Tax Reform Act. Steuerle offers insight into judgements that were not shaped by pure political motivation, as evinced by the fact that he worked for both the center-left Brookings Institute and the Reagan administration, and often

pushed back against policies that were “adopted during the campaign” for president for ones that would actually solve the pressing problems of the era.⁵⁵ As a policy expert, Steuerle offers a glimpse into the complexities of how legislation is made, and how ideas central to problem solving in the financialized era were formulated.

Financial markets were fundamentally transformed in the 1980s. Leo Melamed, the Chairman of the Chicago Mercantile Exchange (CME), was central to this change. Scrutinizing his writings, speeches, and congressional testimony brings light to two key lines of thought. First, how did theory become practice? Melamed was an ardent believer in Milton Friedman and the Chicago School of economics. The two worked together to create the groundwork for the advent of financial futures contracts. Their relationship seems to represent the immense power given to economic theorists within the current literature.⁵⁶ However, Melamed recognized the shortcomings of Friedman’s ideas and sought to limit transactions within the floor of the CME. His proposals were fundamentally antithetical to the free market ethos; however, he would explain that “Friedman wasn’t running a futures exchange and wouldn’t have to contend with the political aftermath” of market failure. Ideas have power, but the people who implemented policies and created the new financial products were ultimately the ones who defined how both the market and politics functioned.⁵⁷

Secondly, Leo Melamed brings clarity into what exactly financial production is, and how this transformed the political economy. This is a complex idea that will take shape over the course of the chapters ahead. However, it is worthwhile to take a moment to outline the general meaning of the term. Industrial production is the process of combining capital, labor, and raw

⁵⁵ C. Eugene Steuerle, *The Tax Decade: How Taxes Came to Dominate the Public Agenda*. (The Urban Institute, 1992), 39.

⁵⁶ Mirowski & Plehwe eds., *The Road from Mont Pelerin*; Burgin, *The Great Persuasion*.

⁵⁷ Leo Melamed and Bob Tamarkin, *Escape to the Futures* (John Wiley & Sons, 1996), 342.

materials together to manufacture a material good that is then sold on the marketplace. While finance has an important role—providing capital in the form of investment in hopes of future returns—it is only one part of the process. Without labor, cars, refrigerators, and even wheat, cannot be produced for the marketplace.

Financial production is the process of turning the expected future value of goods into a product that is sold on the marketplace, thus generating wealth in the present day. Or, explained another way, making the unknown future real is the central aspect of production as imagined future gains flow back through time to our present day. The creation of financial products instigated a new means to create valuations on products ranging from stocks, futures contracts, and bundled mortgages. Profit and growth were not derived from the selling of a material good; rather what is produced is the promise of future growth bound by a contract. Futures on index funds do not necessarily create increased production in the underlying corporations from which the funds are derived. They do, however, provide financial growth for the millions of Americans who invest in them through pension funds, thus creating economic growth. Financiers, such as Leo Melamed, both created these products (Melamed famously created the S&P 500 futures index), and brought them to market.

The wealth generated by this transformation was nothing short of phenomenal. The Reagan Recovery, the Great Bull Market of the 1980s, and the expanding New Economy of the 1990s through present day, all originated in the transformation from industrial to financial production. Unfortunately, the imagined future is a fickle idea to center an economy on.⁵⁸ As we will see with the Savings and Loan Crisis and Crash of 1987, investors can turn on a dime, creating an economic blackhole where there once was a golden mountain. The federal response

⁵⁸ Jens Beckert, *Imagined Futures: Fictional Expectations and Capitalist Dynamics* (Harvard University Press, 2016).

to both disasters, whether direct bailouts or an injection of liquidity by the Federal Reserve, were done to save the financial system. In effect, the government's role shifted from investor of last resort to insurer of last resort.

Unexpectedly, instability imbued a type of virtue to financial producers. In 1987, Congress recognized the potential of financial production, labeling it a "golden egg" of unlimited economic growth. The virtue of financial growth outweighed the cost of an occasional collapse. From the late 1980s through the Great Recession, Congress has continuously passed legislation that fully supported the financial virtuous producers of the world.

Chapter Outline

The transformation of the virtuous producer in the 1980s was the result of a confusing confluence of events. I have organized my investigation around discrete moments that exemplify the change over time that has had a momentous impact on American life. Three fundamental ideas emerge from this strategy. First, the structure traces the transition from industrial to financial production, beginning with the oldest form of production, farming, to the newest, financial derivatives. This illuminates how, although seemingly highly unlike, farming and finance both center on the same idea: the production of a commodity. The key to simplifying the complexity of the financialized economy is understanding how Wall Street became a commodity like wheat. The Farm Crisis, then, offers a model of the Savings & Loan Crisis and 1987 Wall Street crash as the fallout of a commodity bubble.

Secondly, analyzing moments of crises after 1984 interrogates what, exactly, was the Reagan Revolution. Between 1981 and 1983, Reagan signed landmark legislation and implemented executive action that is recognized as the ascension of the new Neoliberal Order. However, his second term is characterized with failure, limitations, and constant revision. Or, as

one political consultant stated, “the Reagan Administration fired all its bullets very early and very successfully in the first two years The most striking thing I discovered is that they don’t have a goddam thing in the pipeline. They don’t have an idea.”⁵⁹ Analysis of Reagan’s second term illuminates the real limitations of the so-called Reagan Revolution. Popular support for the virtuous producer ideal, in the form of the family farmer, spurred Reagan to completely upended his small government strategy and support massive farm subsidies. New Democrats, not free market theorists, took the lead in tax reform that supported a new economy to provide jobs for millions of Americans. And, most importantly, small government reform was muted by the demand to rectify multiple financial collapses through bailouts. Taken as a whole, we will understand the 1980s as a time of confusion, highlighted by new ideas and new problems, rather than a definitive shift to a cohesive political ideology.

Finally, the multiple crises of the latter half of the 1980s offer a way to better understand our own political moment, and how to best address deep-rooted problems of economic inequality. The Farm, Savings & Loan, and Wall Street crises of the mid- to late-1980s all mirror calamities that have shaped American society since 2008. The actions of the 1980s demonstrate that political imaginations, rather than the strict structures of the financialized economy, have limited the country’s ability to combat economic inequality. A robust wealth-generating engine was created, replacing the previous industrial model. However, placing the mantle of virtuous producer on financiers, thus the supply side of the economy, has created political limitations on how best to redistribute wealth. Opportunity for reform is still available. But we must first recognize how, exactly, inequality was shaped and how the nation’s cultural and political

⁵⁹ Jane Mayer and Doyle McManus, “How the Reagan Myth Was Made,” *The Washington Post*, September 18, 1988, C 1-2.

thinking has reinforced a political economy that refuses to address the fundamental problems of the last forty years.

Ch. 1: Farm Crisis

This chapter demonstrates that the ideal of the virtuous producer was a vibrant concept in 1985, exemplified by the “family farmer.” Public support for these bankrupt farmers repudiated Reagan’s call to let the free market reign. Instead, massive public support for active government action and increased taxes resulted in Reagan signing a Farm Bill that cost more than every other implemented since Franklin D. Roosevelt, combined.

The Farm Crisis also illuminates the complexities of Reagan’s second term. The Republican Party fractured around the debate concerning the proper role of the federal government in subsidizing agribusiness—with, unsurprisingly—midwestern Republicans such as Bob Dole leading the call for passage of the Farm Bill. Furthermore, the chapter examines how the Volcker Shock affected Americans on the ground level, as farmers became “canaries in the coal mine” to the increasing importance of credit and debt would impact all Americans by the end of the decade.

Ch. 2: Tax Reform

What types of political-economic reform were possible in the 1980s? This chapter explores how tax policy both shaped politics and the economy throughout the 1980s and beyond. Specifically, there are deep connections between the passage of the Economic Recovery Act of 1981 and the Tax Reform Act of 1986. Both tax reform bills were aimed at encouraging industrial growth in the United States—though just how, and even what industrial growth was—

differed between the two political parties. The financial concept of depreciation played a formative role throughout debates over the 1986 tax policy. Most importantly, the attempts at tax reform had massive unintended effects—most notably on the housing market which helped to spur the Savings & Loan expansion and crisis from 1981 to 1986. Congressional debates, policy papers, and popular publications illustrate how, and more importantly, if, legislative leaders within both parties understood limits and opportunities within financial production.

Ch. 3: Savings & Loan Crisis

The S&L Crisis consisted of the failure of almost one third of the savings and loans associations in the late 1980s. These institutions were understood as the cornerstone to the postwar political economy, creating opportunities for Americans to receive affordable mortgages and home ownership. Beginning in the 1980s, finance capitalism fundamentally transformed the housing market by using mortgages to spur financial growth, despite the underlying “real” growth of the market to be slow or non-existent. These changes touch on the complexity of deregulation in the post-Volcker Shock world, as Regulation Q, a New Deal law limiting the interest rate offered by S&Ls to five percent began to destroy the industry. However, necessary regulatory reform created the groundwork for the transformation of small savings banks into highly speculative financial institutions.

Chapters 4 and 5 reveal how the new political economy of asset appreciation was formed, structured, grew, and created increasing risk and opportunity in the U.S. economy. Most importantly, I argue that the S&L Crisis, creation of financial futures, and the Crash of 1987 do not merely represent a growing bifurcation between the “real economy”—one of manufactured

products—and the financial markets. Speculation was no longer only the means to invest in industrial production. Instead, speculation and resulting financial production were the center of the economy.

Ch 4: Financial Futures

This chapter traces the creation of financial futures in the Chicago exchanges. In the 1970s, the newly elected head of the Chicago Mercantile Exchange, Leo Melamed, began to transform how futures exchanges operated. Moving beyond agriculture, Melamed created new products that focused on global currency exchanges, and then the S&P 500 Index. Financial futures quickly became a booming industry, illustrating how financial production replaced heavy manufacturing as the prime sector for American economic growth.

These new products transformed the marketplace. The distance between the material world of actual goods and the imagined world of future goods almost completely dissolved. Commodities that you had to truck, carry, or barter, such as wheat, were transformed into bundled derivatives that speculated on the future value of Wall Street itself. Congress, recognizing the need to support the source of this new wealth creation, remade century-old laws

Ch. 5: Crash of 1987

The Crash of 1987 was massive. American stock markets suffered one of its largest declines in history, with the S&P 500 alone losing almost 30 percent of its value over five days in October 1987. The total loss of wealth over that period was approximately \$1 trillion.⁶⁰

Despite these astounding figures, the Crash of 1987 is seen as a mere blip on the radar of

⁶⁰ “Report of the Presidential Task Force on Market Mechanisms : Submitted to The President of the United States, The Secretary of the Treasury, and The Chairman of the Federal Reserve Board” (1988), <https://archive.org/details/reportofpresiden01unit>.

massive financial growth. A close analysis of the cause, and congressional response to, the calamity illustrates how financial production creates wealth, how this wealth creation is vulnerable to sudden collapses, and how the federal government responded to disaster.

The Federal Reserve and congressional response to the events of 1987 exemplify the solidification of the financier as the new virtuous producer. Greenspan attacked the panic aggressively, issuing public statements confirming the Federal Reserve's commitment to stabilizing the markets, and adjusting interest rates downwards. This movement, while necessary, created a "moral hazard"—traders began to understand that the Federal Reserve would bail them out of risky almost any venture, no matter the cost. Congress mostly ignored the arguments of Reagan's handpicked investigator, Nicholas Brady, to reform and regulate the financial industry. Instead, Congress agreed with Leo Melamed that any limitation on the American financial markets would effectively kill the "golden egg" of financial production, creating a dynamic mirroring deindustrialization where foreign markets would simply replace the Chicago and New York exchanges. By 1987, financiers, like Leo Melamed, were recognized as the center of the economy, and thus must be protected by state action. Financiers were, in short, the new virtuous producers of wealth.

Epilogue: Country on FIRE

The epilogue briefly explores how the paradigm of the financial virtuous producer continued to frame the political economy for decades to come. The continued development of derivatives and impact of new technology on the NYSE and Chicago futures markets created enormous economic growth in the 1990s and beyond. However, this growth was still marked

with fragility as demonstrated in the Dot.com bubble, and of course, the financial crisis of 2007/8.

The events of 2007/8, however, mark more than an economic collapse. It was end of the of the financier is the unquestioned virtuous producer in American society. Popular protest, from the Occupy movement, to the rise of Donald Trump and Bernie Sanders, illustrate how Americans are, once again, searching for answers to how to best make the economy work for everyone. However, there is hope within the chaos. Financial production offers a path to economic equality. The trick is to figure out, once again, how to deem all working Americans—no matter their gender or race—as virtuous producers. Including service work into this cultural ideal is an important mission of our era. Then speculation can be used for good, creating the framework for direct investment into the lives of everyday Americans, connecting the unlimited growth potential of financial production to the general welfare of the public.

Chapter 1

The Farm Crisis of the 1980s: Virtuous Production and the Limits of the Reagan Revolution

“We are on the threshold in 1985 of repudiating American history itself. You know George Washington said that agriculture was our most important industry. Thomas Jefferson said that our tillers of the soil were our most important citizens; and the backbone of our whole democratic republic. And then David Stockman comes along and says, unlike Washington and Jefferson and Lincoln, farm bankruptcies are needed!” Bishop Maurice Dingman’s words echoed across the overflowing crowd of farmers and their supporters in Iowa State’s Hilton Coliseum. The “soft-spoken Roman Catholic priest” rose to make an impassioned call to arms: “I come before you today to tell you that, if we do nothing, the bells will have tolled for the American dream.” Farmers—America’s most important citizens—had to be protected or America itself would fail.¹

By 1985 the economic severity of the Farm Crisis of the 1980s was clear. Farm debt, accumulated since the 1970s, had risen to a record \$215 billion, with interest alone almost equal to the total farm income of \$22 billion.² Stagnant incomes and high debt caused farm foreclosures across the Midwest, resulting in the worst agricultural emergency since the Great Depression. Bishop Dingman’s words, however, depict more than an economic crisis. After chants and cheers of approval, the Bishop concluded his remarks by declaring that Americans “have forgotten our roots as a people in the land, roots as a people of faith and roots that stretch

¹ “Debating the Farm Crisis and Solutions,” in *The Farm Crisis*, Iowa Public Television, July 1, 2013; William Robbins, “Farmers at Iowa Rally Sound Call for Federal Aide,” *New York Times*, February 8, 1985.

² William Robbins, “Many Economists Hold Federal Policies Have Contributed to Farm Crisis,” *New York Times*, February 26, 1985, A20. Interest on the debt was \$21 billion.

to the dream of our ancestors.”³ What about the Farm Crisis repudiated, for some Americans, the nation’s history itself? And, what did David Stockman have to do with this dream?

Answers to these questions concern the fate of the Reagan Revolution, and how we should interpret its larger significance, in the cornfields and beyond. In his first inaugural address as President, noting a national “economic affliction of great proportions,” Reagan declared, “In this present crisis, government is not the solution to our problem; government is the problem.”⁴ This sentence has come to define the entire decade as the early, triumphant years of Reagan’s first term has dominated our understanding of the 1980s. However, narratives of pro-market ideology and deregulation cannot capture the full meaning of the Reagan Revolution. While studies have mostly grappled with Reagan’s first-term economic policies, this dissertation instead focuses on Reagan’s second term—defined by the Farm Crisis, a second tax bill, the collapse of the Savings & Loan industry, and the Wall Street crash of 1987. All were monumentally significant, as the consequences of Reagan’s first term became clear. Something different happened next. Reagan, and over time, Republicans in Congress, were forced to reformulate their nascent political-economic agenda of limited government oversight and free market ethos to attend to cascading crises.

The Farm Crisis of the 1980s especially offers insight into the full arc of the Reagan Revolution. Simply put, indebted farmers and their advocates in and out of Congress successfully challenged the president’s attempt to apply free market ideology to American agriculture. In the midst of the ongoing rise of service industries, especially including finance—a trend accelerated by Reagan’s early policies—at stake in the Farm Crisis was the place of labor and production in the American economic future. By mobilizing an old idea, the centrality of

³ Robbins, “Farmers at Iowa Rally Sound Call for Federal Aid.”

⁴ Ronald Reagan, “Inaugural Address,” (speech, January 20, 1981), University of Santa Barbara American Presidency Project, <https://www.presidency.ucsb.edu/documents/inaugural-address-11>.

“virtuous production,” critics effectively rolled back Reagan’s free market agenda in agriculture.⁵

The Farm Crisis thus offers a prism through which the interconnections between free market ideology, the welfare state, finance, and electoral politics can be more fully scrutinized. Specifically, the story of the Farm Crisis is a type of blueprint to the multiple crisis and solutions that permeated through Reagan’s second term. Fundamental changes to the American economy stemming from the Volcker Shock remade the political-economy. Old understandings of how taxation, home ownership, and even what a commodity was were reshaped. As explored in this chapter, times of economic growth were, in fact, the early stages of commodity bubbles; each leading to crisis that took overt federal action, often in the form of direct bailouts, to avert. Thus, the 1980s remained a politically fluid and contentious era, despite the notion of the Reagan Revolution’s domination. A new history of the 1980s must account for the fact that a sizable number of even Republican senators openly questioned free market principles, and continued to support welfare state policies, when they applied to their own constituents.⁶

Behind the competing rhetoric of free markets and government subsidies lies the growing centrality of finance in the American economy after 1980. Financialization is mostly understood as the counterpart to deindustrialization. As industrial firms felt the squeeze of global competition, rising oil costs, and high-waged unionized labor, while offshoring American

⁵ The literature of the role of the virtuous producer in American history is robust. See Eric Foner, *Free Soil, Free Labor, Free Men: The Ideology of the Republican Party before the Civil War* (Oxford University Press, 1995); Daniel T. Rodgers, *The Work Ethic in Industrial America, 1850-1920* (University of Chicago Press, 1978); Joyce Appleby, *Capitalism and a New Social Order: The Republican Vision of the 1790s* (NYU Press, 1984); Drew R. McCoy, *The Elusive Republic: Political Economy in Jeffersonian America* (University of North Carolina Press, 1980). Virtuous production remained central into the 20th century, taking the form of the industrial breadwinner. See Elizabeth Cohen, *A Consumers’ Republic: The Politics of Mass Consumption in Postwar America* (Vintage Books, 2003); James T. Sparrow, *Warfare State: World War II Americans and the Age of Big Government* (Oxford University Press, 2011).

⁶ Prasad, *Starving the Beast*. For an account of continued the role of congressional democrats through the era, see Sean Wilentz, *The Age of Reagan: A History 1974-2008* (Harper Perennial, 2008); Patrick Andelic, *Donkey Work: Congressional Democrats in Conservative America, 1974-1994* (University of Kansas Press, 2019).

manufacturing jobs to lower-wage environments, they congruently offered the American consumer financialized debt to purchase the now foreign-made goods⁷. Agriculture is mostly overlooked in this account. The divide between agricultural and industrial production has been, according to Jeffrey Sklansky, part of the “artificial” dualism that often separates the “real economy” of production from finance with the same logic as the difference between “country and town” or “Main Street verses Wall Street.”⁸ The long history of state financial support for American agriculture provides a clear lens to examine how finance and production are deeply intertwined, while and complicating the narrative of pro-market neoliberal ascendance. Congress—specifically here, the Farm Bloc—remained a powerful force that shaped, and in the end, limited Reagan’s free market agenda.⁹

The rise of finance did not end the American welfare state. Debate surrounding the Farm Crisis centered on how to attend to farmers’ bankruptcy, whether through the extension of credit or direct government aid. Although framed as a free market solution, Reagan’s proposed strategy was in fact a plan to provide low-interest government-backed loans that were a continuation of the New Deal mixed economy of taxpayer-funded subsidies. Thus, the government would remain vital to shaping the market even as the Reagan administration promoted agricultural policies that

⁷ Louis Hyman, *Debtor Nation: The History of America in Red Ink* (Princeton University Press, 2011), 281-87; Greta R. Krippner, *Capitalizing on Crisis: The Political Origins of the Rise of Finance* (Harvard University Press, 2011), 138-50; Katherine Newman, *Falling From Grace: Downward Mobility in the Age of Affluence* (University of California Press, 1999); Barry Bluestone and Bennett Harrison, *The Deindustrialization of America: Plant Closings, Community Abandonment, and the Dismantling of Basic Industry* (Basic Books, 1982), 140-92.

⁸ Jeffery Sklansky, “Labor, Money, and the Financial Turn in the History of Capitalism,” *Labor: Studies in Working-Class History of the Americas* 11 (Spring 2014), 26.

⁹ Brent Cebul, Lily Geismer, and Mason B. Williams, eds., *Shaped by the State: Toward a New Political History of the Twentieth Century* (University of Chicago Press, 2018); James T. Sparrow, William J. Novak, and Stephen W. Sawyer, eds., *Boundaries of the State in US History* (University of Chicago Press, 2015). For an analysis on the role of the Farm Bloc in creating progressive reform see, Elizabeth Sanders, *Roots of Reform: Farmers, Workers, and the American State 1877-1917* (University of Chicago Press, 1999). For an analysis on the role of Congress in creation of the New Deal, see Ira Katznelson, *Fear Itself: The New Deal and the Origins of Our Time* (Liveright Press, 2013).

were promised to do the exact opposite.¹⁰ The key shift is that while Reagan administration ended many governmental policies that supported incomes, policies that subsidized debt to help chosen industries, and, as illustrated in this chapter, specific constituents such as white male breadwinners, continued throughout his presidency.

The inconsistent implementation of free market policies at the national level during Reagan's second term exemplifies that morality was the driving ideal that shaped political economic debates of the era. The free market was supposed to revive a moralized marketplace, free from the contaminating influence of "big government" and corrupting special interests. Behind the rhetoric of tax cuts and government overreach lay a principle that hard work and virtue would endeavor a "great national crusade to make America great again."¹¹ Therefore, while the implementation and impact of these policies mattered to how Americans would be materially affected, the meaning behind the rhetoric is central to how and why Americans accepted the principles of the Reagan Revolution. Examining debates through the 1980s demonstrates that the actual policies of neoliberalism mattered less to many Americans than the perceived notion that morality, especially as it underscored work, would shape the economy. At stake in the Farm Crisis is understanding why so many Americans—from congressmen to everyday folk—accepted Reagan's free market rhetoric, and then rebuked it when implemented.¹²

¹⁰ The connection between government taxation, regulation, and credit provisions is central to the formation of the U.S. welfare state. Monica Prasad, *The Land of Too Much: American Abundance and the Paradox of Poverty* (University of Harvard Press, 2012).

¹¹ Ronald Reagan, "Address Accepting the Presidential Nomination at the Republican National Convention in Detroit," (speech, Detroit, MI, July 17, 1980), University of California Santa Barbara American Presidency Project, <https://www.presidency.ucsb.edu/documents/address-accepting-the-presidential-nomination-the-republican-national-convention-detroit>.

¹² Morality and governance are central to postwar conservatism. However, much of the literature that examines this dynamic focus on how women's grassroots organizing shaped the Republican Party from the 1950s to Reagan's election. See McGirr, *Suburban Warriors*; Michelle M. Nickerson, *Mothers of Conservatism: Women and the*

Attention to the Farm Crisis explains how this political-economic morality tale played out by exploring the role of narrative in mediating how Americans understood free market principles.¹³ The government was “not the solution” to economic problems only when governmental action was understood to aid the unworthy.¹⁴ Cultural ideals dominated the rhetoric of who was worthy of government support. Both urban and rural Americans suffered economically, but only the labor of white farmers was labeled as virtuous. The identification of indebted businesses as mythologized family farmers who tirelessly work the land to produce for the common welfare, their farms self-sufficient and independent, thus liberated from the degradations of the profit motive—has been a cultural ideal since Jefferson’s romanticized writings in his *Report on Manufacturers*.¹⁵ Despite extensive literature examining agriculture’s centrality to the marketplace and the development of American capitalism, this cultural narrative still motivated public discourse.¹⁶ Preserving the morality of virtuous production remained the key arbiter when Americans were faced with a choice between free market and a New Deal style direct aid economic strategies.

Postwar Right (University of Princeton Press, 2012); Bethany Moreton, *To Serve God and Wal-Mart: The Making of Christian Free Enterprise* (Harvard University Press, 2009).

¹³ Donald MacKenzie, *An Engine, Not a Camera: How Financial Models Shape Markets* (Harvard University Press, 2008); Alex Preda, *Framing Finance: The Boundaries of Markets and Modern Capitalism* (University of Chicago Press, 2009); Peter Knight, ed., “Fictions of Finance,” special issue, *Journal of Cultural Economy*, 6 (2013); Aaron Carico and Dara Orenstein, eds., “The Fictions of Finance,” special issue, *Radical History Review*, 118 (Winter 2014).

¹⁴ Ronald Reagan, “Inaugural Address,” (speech, Washington, DC, January 20, 1981), University of California Santa Barbara American Presidency Project, <https://www.presidency.ucsb.edu/documents/inaugural-address-11>.

¹⁵ The virtuous producer ideal that the health of farmers directly reflected the health of American democracy was all but codified in the Agricultural Adjustment Act of the 1930s as it was understood that “[v]igorous and sustained action [was] required for restoring the impaired resources on whose preservation continuance of the democratic process in this country to no small extent depends.” See, L.C. Gray and Henry A. Wallace, United States National Resources Committee, *Special Committee on Farm Tenancy* (Washington, D.C.: U.S. GPO, 1937).

¹⁶ See, for example, Christopher Clark, *The Roots of Rural Capitalism: Western Massachusetts, 1780-1860* (Cornell University Press, 1990); Wilma Dunaway, *The First American Frontier: Transition to Capitalism in Southern Appalachia, 1700-1860* (University of North Carolina Press, 1996); David R. Meyer, *The Roots of American Industrialization* (Johns Hopkins University Press, 2003).

When Reagan rode into office, for free market supporters, deindustrialization, stagflation, and general economic crisis was wrought by “big government’s” interference. Once free from government overregulation and over taxation, the market would spur private savings, investment, productivity, and growth. Unleashing market efficiency would give rise to a renewed morality, undermining dependency upon government support, whether it was black “welfare queens” or white Iowa farmers, and reward hard work and production. In the arena of agriculture, the Reagan administration argued that government handouts, in the form of direct payments, would only further harm American farmers by propping up the most inefficient amongst their ranks. The free market would effectively cull these unproductive farmers from the economy, resulting in an efficient and more economically viable farming sector.

To return to that February night in 1985, according to Bishop Dingman, farmers faced ruin if they were exposed to the free-market ideology that Reaganite David Stockman espoused. Many farmers, a bipartisan coalition of U.S. congressmen, and a number of prominent celebrities, fervently agreed. They stated that family farmers were more than businesspeople. They represented the core of American culture as the embodiment of the virtuous producer ideal. The Farm Crisis that emerged by Reagan’s second term illustrates that many Americans supported the ideal, if not reality, of the virtuous, productive farmer. Farmers—although in debt, often because of leveraged, speculative investments incurred in the pursuit of increased profit—were nonetheless recognized by the public as deserving of direct government aid. Thus, Reagan’s arguments were repudiated because the free marketplace threatened to destroy the very people who Reagan promised it would help: the men who, by working the soils, remained true, putatively, to the republican vision of the Founders.

Ronald Reagan's famous quip that "there really is something magic about the marketplace when it's free to operate" has come to characterize both his presidency and the general zeitgeist of the 1980s. However, free market rhetoric was not a new idea in the 1980s. Although tangential to "free enterprise" rhetoric, the free market became a panacea as early as Nixon's first term. For American farmers specifically, this moment of rhetorical change is particularly significant, as the new solution of "free market agriculture" in the early 1970s manifested into the Farm Crisis in the 1980s.¹⁷

In 1971, President Nixon prompted U.S. Department of Agriculture secretary, Earl Butz, to improve farmers' income to secure their vote in the 1972 election.¹⁸ Butz responded to Nixon's demand with a rather simple solution: expand the country's agricultural export trade. Butz found a ready market for America's wheat, corn, and other feed grains from an unlikely buyer, the Soviet Union. Victims of massive crop failures in 1971, the Soviets became the world's leading consumer of American agriculture the next year with 19 million metric tons of grain, earning farmers an estimated \$1.1 billion. In response to the dramatically increased market, Butz engaged in a speaking tour encouraging farmers to "get big or get out" by planting "fence row to fence row."¹⁹

The 1973 Farm Bill implemented Earl Butz's "adapt or die" rhetoric. In order to meet the call to produce, restrictions on Federal Land Bank lending were removed, causing rural banks to

¹⁷ Phillips-Fein, *Invisible Hands*; Fones-Wolfe, *Selling Free Enterprise*.

¹⁸ U.S. Congress, Senate, Committee on Agriculture and Forestry, *Nomination of Earl Lauer Butz*, 92nd Cong., 1st sess., Executive Report No. 92-13, November 23, 1971; Robert Mason, *Richard Nixon and the Quest for a New Majority* (University of North Carolina Press, 2004), 192-234.

¹⁹ U.S. Congress, Senate, Committee on Government Operations, *Russian Grain Transaction Permanent Subcommittee on Investigations*, 93rd Cong., 1 sess., July 20, 32-24, 1973, pp. 15-21. The initial sales to the Soviets were done in secret and took a full year before a Congressional Committee investigated the transactions. See Joel Solkoff, *The Politics of Food*, (Sternberg Press, 1985), 46-56; Heather Scholar, "Federal Farm Policies Hit," *Reading Eagle*, October 23, 1973, 6.

offer farmers large loans to expand production.²⁰ Farmland values increased across the country. In Iowa, the average price of an acre of farmland grew from \$419 in 1970 to \$2,066 in 1980.²¹ For the first time in generations, farming was seen as an expanding business opportunity. The population of mid-level farmers—classified as farmers whose income ranged from \$40,000 to \$200,000 a year—increased a shocking 250 percent.²² Free market deregulation had both increased the American export trade and provided economic growth to the American heartland.

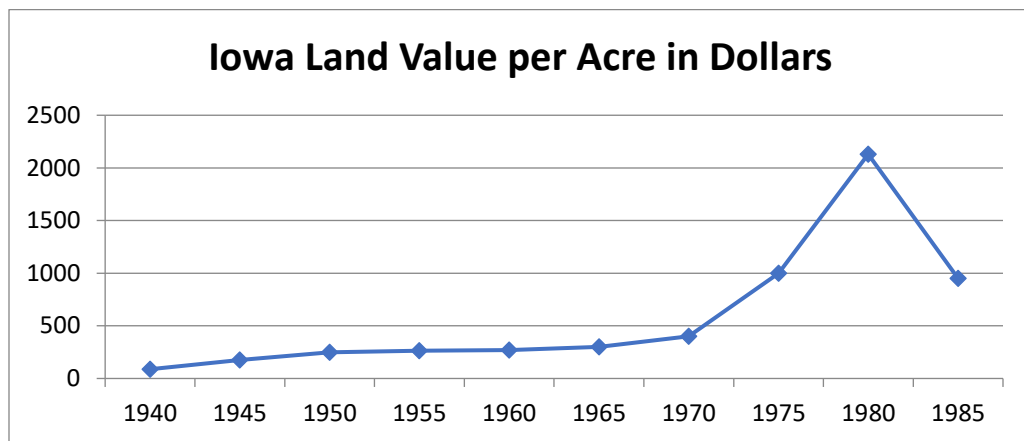


Figure 1. “1987 Iowa Land Value Survey,” FM-1825 (Iowa State University Extension, March 1988).

However, the triumph of the free market was an illusion. High export revenue, increased farmer income, and rising farmland values all hid the basic fact that the 1973 Farm Bill had created a commodity bubble. Throughout the 1970s, farmers borrowed against their appreciating land to acquire larger loans, all to further expand production. The three hundred percent increase in export revenue obscured the rapidly increasing level of farm debt—\$54 billion in 1971 to \$212 billion in 1985. Between 1973 and 1979, increasing export revenue outpaced the growing

²⁰ Clifton B. Luttrell, *The High Cost of Farm Welfare* (Cato Institute, 1989), 58.

²¹ “1987 Iowa Land Value Survey,” FM-1825 (Iowa State University Extension, March 1988). Iowa per acre price adjusted for 2023 dollars: \$419 in 1970 is \$3,316; \$2,066 in 1980 is \$7,946.

²² Heather Ball and Leland Beatty, “Blowing Away the Family Farmer: The Debt Tornado,” *Nation*, Vol. 239 (November 3, 1984), 442.

level of debt. However, by 1981, China, India, and Brazil increased production of corn and other grains, creating a glut in the global market.²³

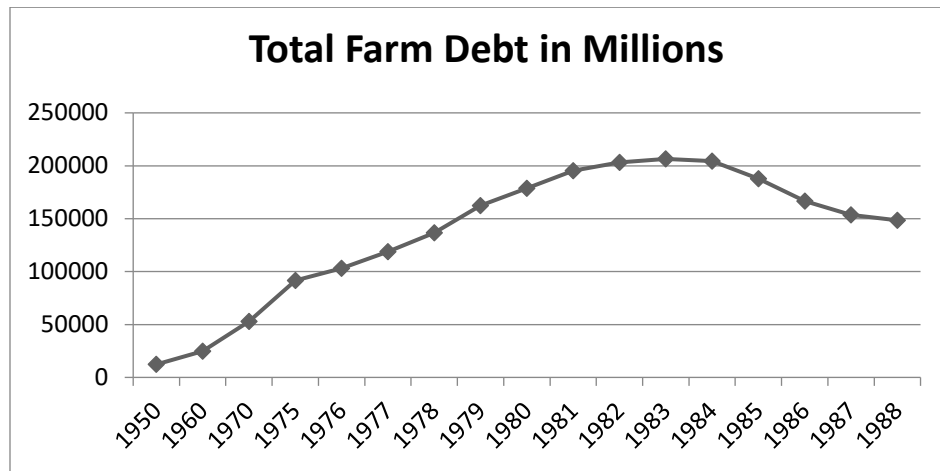


Figure 2. U.S. Department of Agriculture, Economic Research Service, *The U.S. Farm Sector: How Is It Weathering the 1980's?* Report no. AIB-506 (Washington, April 1987)

The farmers' situation went from bad to catastrophic in January of 1980. In response to the Soviet invasion of Afghanistan, President Carter implemented an "embargo on the sale of \$2.6 billion worth of corn, wheat and soybeans."²⁴ The export market all but disappeared. Farmland values plummeted by \$146 billion between 1982 and 1985, an amount equal to the "combined assets of IBM, General Electric, Kodak, Proctor & Gamble, Dow Chemical, McDonald's, RCA, Upjohn, Weyerhaeuser, and CBS."²⁵ Farm income evaporated. In 1973, farm households earned fifty percent *above* the national average; by 1984, they earned only eighty

²³ Kenneth Sheets, Steve Huntley, Douglas Lyons, and Joanne Davidson, "For Farmers, Big Crops Bring Big Troubles," *U.S. News and World Report*, November 2, 1981; David Moberg, "Should We Save the Family Farm?" *Dissent*, Spring, 1988, 205.

²⁴ "Grain Becomes A Weapon - Carter Uses It to Pressure the Soviets, but U.S. Farmers Call for Help," *Time*, Vol. 115, Issue 3, January 21, 1980, 12.

²⁵ U.S. Congress, Senate, Committee on Governmental Affairs, Subcommittee on Intergovernmental Relations, *Governing the Heartland: Can Rural Communities Survive the Farm Crisis?* 99 Cong., 2 sess., 1986 (Washington, January, 6, 1986); Osha Gray Davidson, *Broken Heartland: The Rise of America's Rural Ghetto* (University of Iowa Press, 1996), 17.

percent of the national average.²⁶ In Iowa, average net income per farmer fell from \$17,680 in 1981 to \$7,376 in 1982. A year later, the number fell again to only \$1,891.²⁷ Congruently, in October of 1979, the Volcker Shock commenced when the Federal Reserve raised interest rates to curb inflation. Farmers across America's wheat and corn belts had to pay higher interest for loans on land that had fallen dramatically in value all as their income plummeted to poverty levels.

Despite increasingly perilous position of many farmers, the crisis remained relatively unknown to the wider public in the early 1980s. Although local congressional representatives attempted to cast a light on the plight of the farmers, the newly-elected Reagan administration immediately began to enact an agenda to decrease the size of the government. Austerity measures were central to this agenda. Government spending on social programs that benefitted poor Americans were cast as fraudulent and unnecessary, and thus were placed on the budgetary chopping block. However, the administration soon began to depict as-of-then necessary programs as unneeded and even fraudulent.

American farmers, according to the Reagan administration, were welfare frauds. David Stockman, Reagan's director of the Office of Management and Budget, contended that the "worst nonsense of all in the budget . . . was farm subsidies." Stockman stated that the New Deal's Agricultural Adjustment Act had "turned the wheat, corn, cotton, and dairy business into a way of life based on organized larceny."²⁸ Stockman's use of "larceny" directly connected farmers to Reagan's infamous imagery of the "welfare queen." Based off a single woman, Linda Taylor, who was convicted of fraud in 1977, Reagan brought the image of the Chicago "welfare

²⁶ U.S. Department of Agriculture, Economic Research Service, *The U.S. Farm Sector: How Is It Weathering the 1980's?* Report no. AIB-506 (Washington, April 1987), iv, 12.

²⁷ U.S. Department of Agriculture Economic Research Service, *Economic Indicators of the Farm Sector, State Income and Balance Sheet Statistics* (Washington, 1983).

²⁸ David Stockman, *The Triumph of Politics: How the Reagan Revolution Failed* (Harper & Row, 1980), 152-53.

queen” to national prominence in his presidential campaign of 1980. In speech after speech Reagan used a racialized and gendered depiction of a “new Cadillac-driving” black woman welfare recipient in Chicago who used “eighty names, thirty addresses” to collect a “tax-free cash income” of over “\$150,000 a year.” This rhetoric effectively created an image that all welfare recipients were African American women who shirked hard work to live off the taxpayers’ dole in the minds of millions of Americans.²⁹

Reagan’s words reflected a perceived welfare crisis that pervaded the country in the early 1980s. Between 1965 and 1970, the nation’s welfare program grew from “3.3 million to 7 million people nationally.” Newly enacted legal reforms, the implementation of War on Poverty programs, and early moves in deindustrialization all “verged to swell the number of people receiving assistance, particularly among African Americans in urban areas” while the national economy struggled through the stagflation of the 1970s and high unemployment of the early 1980s. By tapping into a national feeling that the entire welfare program was an unjustifiable use of taxes to transfer money from hardworking Americans to “undeserving, unproductive poor people,” Reagan cast himself as a leader in reform who would end all payments to undeserving freeloaders.³⁰

Considering the racial and gendered stereotypes central to the creation of the “welfare queen” fiction, the administration’s turn against farmers can be first perceived as puzzling. However, the man behind many of Reagan’s policies, David Stockman, was a true-believer in

²⁹ Reagan’s story was based off a series of *Chicago Tribune* articles covering the case of Linda Taylor, a Chicago woman charged with multiple cases of fraud. See George Bliss, “Cops Find Deceit—But No One Cares,” *Chicago Tribune*, September 29, 1974, 3; George Bliss, “Panel Probes Welfare Cheating Charges,” *Chicago Tribune*, September 30, 1974, 1; David Zucchino, *Myth of the Welfare Queen* (Scribner, 1997), 65; Julilly Kohler-Hausmann, “Welfare Crisis, Penal Solutions, and the Origins of the ‘Welfare Queen,’” *Journal of Urban History* 41 (Issue 5, 2015), 757, 762-63.

³⁰ Kohler-Hausmann, “Welfare Crisis, Penal Solutions, and the Origins of the ‘Welfare Queen,’” 757.

free markets. Thus, he sought to root out all dependency on the federal government, including that of farmers.

Stockman's argument was grounded in the fact that despite the long and consistent decrease in actual farms and farmers, the United States Department of Agriculture (USDA) continued to expand in power, size, and funding between the years 1950-1980. Between 1950 and 1970, the number of American farms declined from six million to three million. Fewer farms and farmers resulted from an increase in farm size (from 200 to 400 acres), specialization, and capitalization.³¹ American agriculture was so productive in 1980 that only a very small percentage of farmers provided America's food supply. In total, about four percent of farmers grew about half of all food commodities.³² The American public only consumed three-fifths of the total food produced; the other two-fifths went to export or federal storehouses. Because federal subsidies underwrote production, the largest portion of federal farm expenditures went to large operators, with seventeen percent of American farmers receiving nearly sixty percent of all agricultural subsidies.³³

³¹ Between 1960 and 1970 the farm population declined from 15.6 million to 8 million, a dramatic 50 percent decrease. See U.S. Department of Agriculture, Economics, Statistics and Cooperative Service, *1978 Handbook of Agricultural Charts*, (Washington, 1978); Ingolf Vogeler, *The Myth of the Family Farm: Agribusiness Dominance of U.S. Agriculture* (University of Colorado Press, 1981), 3; U.S. Department of Agriculture, Economic Research Service, *Economic Indicators of the Farm Sector: National Financial Summary*, (Washington, 1971); Joel Solkoff, *The Politics of Food*, 12.

³² Farms with gross annual sales between \$250,000 and \$500,000 [3% of total farms] provided 17%; farms with gross sales above \$500,000 [1% of U.S. farms] provided 32 percent.

³³ U.S. Department of Agriculture, Economic Research Service, *The U.S. Farm Sector: How Is It Weathering the 1980's?* Report no., AIB-506 (Washington, April, 1987), iv-v. Large farms (average sales of \$200,000 or more) doubled in number between 1960 and 1982 as small farms (average sales of \$10,000 to \$40,000) fell from 1.2 million to 500,000. This trend continued the long-term shift to larger farm operations, which produced more commodities more efficiently. See U.S. Department of Agriculture, Economic Research Service, *Issues in Agricultural Policy: Challenges in Designing U.S. Farm Policy*, Report no. AIB-518 (Washington, June 1987), 2.

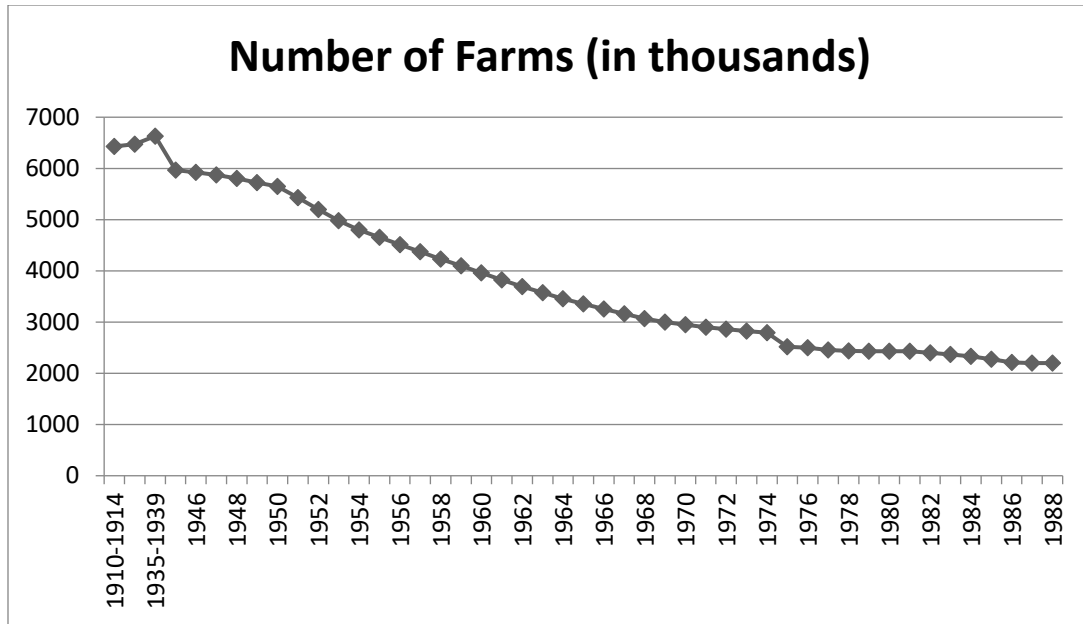


Figure 3. US Department of Agriculture, Economic Resource Service, *Economic Indicators of the Farm Sector, National Financial Summary*, 1988 (October, 1989).

By 1981, the federal government paid farmers over four billion dollars in subsidies to *not* grow staple crops. Funds for these subsidies were allocated to, and distributed by, House and Senate members of the Agricultural Committee. These congressmen represented districts composed of primarily the cash crops of cotton, wheat, and feed grains. A 1974 report found that “over \$600 million was received by congressional districts whose representatives were on the important House Agricultural Committee. Of the leading ten districts receiving subsidies in 1968, five had members on the House committee.” The same report found that the allocation of funds was a bipartisan affair. Although most members of the Senate committee were Democrats, the highest subsidies were received by Republican members of the House Agricultural Committee—Texas (\$117 million, Bob Price) and Kansas (\$102 million, Bob Dole). The congressional Agricultural Committee gave increasing financial support to their home districts even as the recipients of these subsidies became larger, more profitable, and corporatized. Stockman argued that these subsidies were fraud as the largest and richest agricultural producers,

growers of corn and wheat, received unnecessary payments from hardworking American taxpayers.³⁴

According to Stockman, subsidies were unnecessary because farmers were already opulently compensated by the market for their work.³⁵ Under his guiding hand, the initial Reagan Budget of March 10, 1981 “cancelled nearly every single farm subsidy program.” This dramatic move would reduce federal agricultural subsidies from over \$30 billion to “less than \$10 billion over five years”³⁶ Although this effort failed in 1981, Stockman’s actions illustrate that the Reagan Administration’s “free market farm program” effectively recognized farmers as businessmen who did not need government support to succeed.

Cutting governmental expenditures, taxation, and regulations were all central to how the Reagan administration planned to revive the American industrial economy. Just a month before the release of the administration’s first budget, Reagan addressed the nation, stating that American businesses were “being priced out of the world market” due to high taxation and over-regulation. Although the strategies of Reaganomics were to “make it possible for industry to modernize” and “increase productivity” of industrial America, it is important to take Stockman’s view of farmers as businessmen as part of this strategy. The free market was the solution for all economic problems. Farming was the same as steel manufacturing. Thus, government support for agriculture was, in the understanding of Stockman and other members of the Reagan administration, just as harmful as high rates of taxation and zealous enforcement of regulatory

³⁴ U.S. Department of Agriculture, Economic Research Service, *Economic Indicators of the Farm Sector: National Financial Summary*, (Washington, 1985); Stanley D. Brunn, *Geography and Politics in America* (Harper and Row, 1974), 334; Vogeler, *The Myth of the Family Farm*, 9, 21-31, 181.

³⁵ The average wage in 1980 was \$12,513. Thus, farmers who received 60% of federal subsidies in 1980 made, on average, twenty to nearly forty times more than the average U.S. citizen, before expenses (\$250,000 to \$500,000 or more). Figuring expenses rarely exceeded 50% of gross income, the average corn and wheat farmer who received federal payments still made substantially more than the average American. See Social Security Administration, *National Average Wage Index*, “National Average Wage Indexing Series, 1951-2015,” <https://www.ssa.gov/oact/cola/AWI.html>.

³⁶ Stockman, *Triumph of Politics*, 153.

rules. The Farm Crisis, then, was understood as another front of American deindustrialization to the Reagan administration. The government had corrupted the market, making it impossible for American farmers to compete internationally. The cure—though painful for some—would result in a robust and dynamic agricultural sector.³⁷

The “silent crisis” of American farming gained media attention in May of 1984.³⁸ Over the course of the next year, media coverage created a narrative that the 1985 Farm Bill would decide the fate of America’s farmers. The Reagan administration held firm to its philosophy to let the free market operate: “The primary function of the Government should be to insure small and moderate-size farmers against natural disasters and price fluctuations that have threatened them since the beginning of time. . . . But the Government cannot protect farmers either from themselves or from inevitable changes in technology and the marketplace.”³⁹ Some farmers agreed. In 1985, Gordon Jameson, a farmer who raised “soybeans, corn, and hogs” on a northern Illinois farm stated that the federal government “should ‘untie the farmers hands’ from these inefficient programs and turn them loose to produce for the market.” Robert Delano, President of the conservative American Farm Bureau, advocated for a “free market philosophy” because “government management ‘leads to shutting down the U.S. farm production.’” Furthermore, government price supports were argued to be ineffective because “the lion’s share of federal farm spending goes to larger operators, not to the idealized small family farm.” According to the free market view, the Farm Crisis was a mere readjustment in the marketplace. Only inefficient,

³⁷ Ronald Reagan, “Address to the Nation on the Economy,” February 5, 1981 in *Public Papers of the Presidents of the United States: Ronald Reagan, 1981* (Washington, 1982), 1:79-83.

³⁸ Agricultural economist, Neal Harl recognized a page-four article in the *Des Moines Register* in May of 1984 as a catalyst for expanded media coverage. Harl, however, states that he had contacted the paper, thus claiming the mantel as the Farm Crisis whistle-blower. See Neal Harl, *The Farm Debt Crisis of the 1980s* (Iowa State University Press, 1990), 48, 222.

³⁹ “The Flight of the Farmer,” *America*, March 23, 1985, 227.

over-leveraged producers were losing their farms. A bailout would only distort the marketplace, further damaging the American agricultural export trade.⁴⁰

Additionally, the administration argued that the current U.S. farm policy inflated the prices of agricultural commodities above world market levels, forcing the federal government to buy and store ever larger stockpiles. This period witnessed a dramatic fall in U.S. agricultural exports as foreign nations inundated the world market with cheap wheat and corn.⁴¹ Despite the growing financial collapse, the administration continued to promote policies to lower price supports for major export commodities (wheat & corn) in order to match prevailing world prices. According to the administration, this measure would make U.S. farmers competitive in the global marketplace and reduce the government's large grain surpluses. Instead of direct government payments, the administration, supported by the American Farm Bureau, offered increased export financing to expand overseas demand. These export subsidies, in the form of low interest government loans from the Farmers Home Administration (FmHA), would theoretically pay for themselves in higher farm income. Reduced government control—mainly ending subsidies that paid farmers not to grow—and the export market were promoted as the simple solution to both cut the cost and increase the profitability of American agriculture.⁴²

Let us take a moment to fully consider the Reagan administration's proposal. In order to help struggling farmers, the administration offered low interest government-backed loans from the FmHA, not private banks. Is this a "free market" strategy? Many of those within the Reagan administration would answer yes—an extension of credit, even one backed by the public, is still

⁴⁰ Henry Eason, "Agriculture at the Crossroads: 1985 Could See a Historic Turnaround in Farm Policies set in the New Deal," *Nation's Business*, Vol. 72, Issue 8 (August 1984), 36; *See also* Heather Ball and Leland Beatty, "Blowing Away the Family Farmer: The Debt Tornado," *Nation*, 239 (November 3, 1984), 444.

⁴¹ American agricultural exports declined by more than 20% between 1981 and 1983, while real commodity prices plummeted 21% during the same period. *See* Ball and Beatty, "Blowing Away the Family Farmer," 442-44.

⁴² Prasad, *Land of Too Much*; Henry Eason, "Food Exports: A Case of Too Many Cooks," *Nation's Business* 72, Issue 8 (August 1984), 57.

a solution that adheres to the market-based parameters of contract, profit, and finance. However, we must recognize this for what it is: a mixed economy that has shifted focus from demand (labor & income), to supply (capital & credit). However, by labeling this as a free market solution, the Reagan administration was attempting to mask direct government loans through the FmHA as the workings of the private marketplace.

Many other farmer organizations opposed the administration's approach. According to Cy Carpenter, president of the National Farmers Union, "market-oriented farming really means 'risk-oriented' production." The free market "leaves the well-being of consumers and farmers to chance. Either we rely on the anarchy of the marketplace, with its inherent peaks and valleys in prices and supply, or we can adapt a national, coherent policy of supply-management with program benefits targeted to family scale sector of agriculture."⁴³ Ken Kreego of the American Agricultural Movement called the reliance on the export market a false choice. Kreego made a racialized argument that foreign farmers did not have the same lifestyle as Americans and had lower input costs as American farmers "can't compete with a water buffalo and a grass hut." Thus, American agriculture will always cost more than that produced in China, Argentina, and other emergent economies. These organizations contended that food production was too important to rely on market dynamics. Fluctuations brought high food costs to the American consumer and financial trouble to the American farmer. Accordingly, price supports and continued regulation in the form of mandatory production controls were essential to the success of American agriculture. Therefore, the policies of free markets, deregulation, and limited government should not apply to agriculture.⁴⁴

⁴³ Eason, "Agriculture at the Crossroads," 36.

⁴⁴ Peter Downs, "Seeds of Discontent: Farmers Plow New Political Ground," *Progressive*, 50 (July 1986), 30-33.

Despite the division between the Farm Bureau and the National Farmers Union, the debate over Reagan's free market policies was not set along strict political lines. Reflecting what Bill Alexander (D-Ark) called the "bi-partisan spirit of the debate," the entire North Dakota legislature—mostly composed of Republicans—flew to Washington D.C. to personally press Congress for increased subsidies for farmers in late February of 1985. During a hearing on "Direct Action for the Farmer," these legislatures were joined by other Republican and Democratic representatives from across the country to argue for continued and increased direct subsidies for farmers.⁴⁵

The debate quickly coalesced over the mid-level farmer. These farmers were the hardest hit by the debt crisis. Unlike large and small producers, mid-level farmers borrowed heavily in the late 1970s.⁴⁶ Harold Breimyer, of *Challenge* magazine, argued that these farmers "were enticed . . . by prospects of speculative gain."⁴⁷ Unsurprisingly, David Stockman led the charge against these "inefficient producers." In response to a proposed bill that called for \$4 billion to restructure farm debt, Stockman testified before the Congressional Budgetary Committee that "For the life of me, I cannot figure out why the taxpayers of this country have the responsibility to go in and refinance bad debt that was willingly incurred by consenting adults who went out and bought farm land when prices were going up and thought they could get rich."⁴⁸ Tellingly, Stockman never once labeled these failing businesses as "family farms." Free market advocates considered these farmers less as humble salt-of-the-earth producers and more as business-minded

⁴⁵ *Congressional Record* Senate Hearing on 1985 Budget, *Bipartisan Hearing on Direct Action to Farmers*, 99 Cong., 1 sess., 131, Feb. 27, 1985, pp. 3880, 3853.

⁴⁶ Sheets, Huntley, Lyons, Davidson, "For Farmers, Big Crops Bring Big Troubles," *U.S. News and World Report*, November 2, 1981. "Hardest hit are young farmers who borrowed heavily in recent years to purchase land and equipment needed to get started in the business. Bankers warn that many of them will be unable to get enough credit to plant next year's crops unless commodity prices rise and interest rates dip."

⁴⁷ Harold Breimyer, "Agriculture: Return of the Thirties?," *Challenge*, 25 (July-August, 1982), 35-41.

⁴⁸ *Congressional Record*, Senate Hearing on 1985 Budget, *The Family Farm in America*, 99 Cong., 1 sess., 131, February 7, 1985, Part 2, p. 2238.

market speculators. The market had turned, and they simply had to suffer for their poor financial management.⁴⁹

Senator Tom Harkin (D) of Iowa offered a counter argument: the federal government had the responsibility to protect farmers through direct subsidies. The senator said that Iowa was “literally dying” as family farmers who could not find their way out of debt had resorted to suicide and other acts of violence. According to Harkin, the families who were at the center of the Farm Crisis were not business speculators. They were hardworking Americans who produced cheap and plentiful food. They had worked the same land for generations and deserved support from the American taxpayer. These beliefs were so deeply held that according to Sen. Harkin, Stockman’s words to the contrary would get him “lynched on site” if he ever visited Iowa in person.⁵⁰

“Agriculture is in the worst crisis since the thirties” declared David Boren, a conservative Democrat from Oklahoma during the February 1985 budgetary session. Boren, like Harkin, vigorously defended the “importance of preserving the family farm unit” for maintaining the “cornerstones of our American democracy.” Boren, however, took his argument one step further and directly challenged the Reagan administration’s core free market principle.⁵¹ Summarizing Stockman’s argument, the Senator stated that:

Some have said . . . that [the Farm Crisis] is the result of
greed by the farmers and that farmers, in an effort to make

⁴⁹ Stockman stated that if the market had remained profitable, there would be no hearing because the speculative farmer would be receiving high returns on his investment. *See Congressional Record*, “David Stockman, Speaking on 1985 Budget,” 99 Cong., 1 sess., 131, February 7, 1985, Part 2, p. 2238.

⁵⁰ John McLaughlin, “Farm Blues,” *National Review*, 37 (March 22, 1985), 24; Joshua Hammer “Double Slaying in Rural Minnesota Spotlights Distress of America's Debt-Ridden Farmers,” *People Weekly*, 20 (October 31, 1983), 129-131. For an analysis on the rise of suicide and drug dependency following the Farm Crisis *see*, Kathryn Marie Dudley, *Debt and Dispossession: Farm Loss in America’s Heartland* (University of Chicago Press, 2000).

⁵¹ Senator Boren supported tax cuts and voted in favor of nominating Robert Bork, Reagan’s controversial pick for the U.S. Supreme Court in 1987.

millions in the 1970s, greatly expanded their operations . . .
and therefore they deserve any result which may follow.
They are saying that farmers should be forced to tough it
out on the free market.

Boren then declared, “Of course, they do not tell us that the free market does not exist; that our farmers are forced to compete internationally where production and sales are subsidized.” The Senator’s analysis accurately describes the core fallacy of free markets and international trade. Nations, to boost their own exports, often subsidize key industries, including both manufacturing and agriculture. Boren omitted that the United States is also guilty of this practice. Boren was correct, however, when he stated that in the 1970s “the Government itself called upon the American farmer to rise to the great challenge of feeding the world, to expand production, to plant fencerow to fencerow to meet the increased export demand of a world crying for food.” Government policy, not greed, “urged farmers to go to the Farmers Home Administration and borrow money to meet this great challenge.” Furthermore, it “was said that the solution to agricultural problems had finally been discovered—the export market and the free market.” Senator Boren’s statement concisely connects the Farm Crisis to the implementation of “free market agriculture” by President Nixon and his Secretary of Agriculture, Earl Butz, a decade earlier.⁵²

The truth is something more complicated than either Boren’s or Stockman’s arguments. In the 1970s, the USDA encouraged farmers to enter the “free market” and feed the world. Many farmers expanded production in response to an opportunity to invest in a growing business model, not patriotic duty. When the export commodity bubble burst, those who answered Butz’s

⁵² *Congressional Record*, Senate Hearing on 1985 Budget, *The Family Farm in America*, 99 Cong., 1 sess., 131, February 7, 1985, Part 2, p. 2075.

call to expand were left with outsized mortgages and falling income. The debate between Stockman, Boren, Harkin, and other government officials failed to elucidate the complexity of the situation. Instead, arguments of free markets and the condition of family farmers who represented “the cornerstones of our democracy” dominated the 1985 budgetary proceedings.⁵³

Despite the dramatic actions of the North Dakota legislature and the sensational words of Senators Harkin and Borins, the Agricultural Committee did not have a veto-proof majority in passing the 1985 Farm Bill. Shortly after the February 1985 budget debates, Reagan vetoed the proposed farm-aid package, calling it “a massive new bailout that would add billions to the deficit.” Reagan had “expressed sympathy for farmers in dire financial straits,” but held fast to his belief that “the government cannot ‘bail out every farmer hopelessly in debt’ and warned Congress that he would be quick to reject similar measures in the future.”⁵⁴ To counter Reagan’s resistance to government-financed farm aid, Boren, Harkin, and other members of the Agricultural Committee called upon three women who specialized in reaching a mass audience.

In May of 1985, Sissy Spacek, Jessica Lange, and Sally Field were asked to give statements as “expert witnesses” before the House Democratic Caucus Task Force on Agriculture.⁵⁵ In 1984, these women starred in three separate films that focused on the perilous condition of the family farmer, just as the Farm Crisis became national news. In *The River*, Sissy Spacek portrayed a family farmer in Tennessee who faced foreclosure, floods, and other calamities. *Places in the Heart* connected the farm crisis of the 1980s to the Great Depression.

⁵³ *Congressional Record*, Senate Hearing on 1985 Budget, *The Family Farm in America*, 99 Cong., 1 sess., 131, February 7, 1985, Part 2, p. 2075.

⁵⁴ George de Lama and Lea Donosky, “Reagan Kills Farm Bill: No ‘Bailout’ for Farmers Deep in Debt,” *Chicago Tribune*, March 7, 1985.

⁵⁵ *Congressional Record*, House Democratic Caucus Task Force on Agriculture, *Sally Field, Jane Fonda, Jessica Lange, and Sissy Spacek Speak on The Farm Crisis*, 99 Cong., 1 sess., 131, No. 60 (May 9, 1985), S 5727. Jane Fonda, whose father portrayed Tom Joad in the 1940 film adaptation of Steinbeck’s *The Grapes of Wrath*, was also asked to give a statement.

Set in 1935, the story tells of a widow played by Sally Field who works to save her family farm. Most famously, Jessica Lange starred in *Country*. Set during the then current Farm Crisis, Lange and her husband portray a family who desperately worked to keep their family farm in rural Iowa from economic ruin.⁵⁶

All three films connected the cultural importance of the family farmer with the anxiety faced by Americans in the early 1980s. Deindustrialization and a growing service economy marked the dramatic shift from an industrial postwar economy to the postindustrial economy, highlighted by the increased dominance of service work.⁵⁷ The family farmer became a symbol of democratic values and industrial producerist work ethic. The films portrayed vulnerable farmers fighting against bank foreclosure by relying on their family, hard work, independence, and a faith that the land will provide to gain the upper hand against unbeatable odds.

The move to invite three actresses who played farmers on screen, rather than actual farmers, at first seems an odd move. However, scholarship has explored how Reagan's experience as an actor made him a highly effective politician. He instinctively knew how to communicate patriotic or moral ideals behind policy proposals, and more importantly, created a public persona that compelled trust and stability after twenty years of political unrest. Under this framing, using three actresses to portray the hardships of farmers signifies how Democrats were learning to embrace strategies of the Republicans under Reagan. Effectively communicating the plight of bankrupt farmers was key to tug on the moral heartstrings of Americans in order to gain support for public policy—it did not matter if who was speaking were actual farmers. Field, Spacek, and Lange were, like Reagan, adept public speakers by trade. Their ability to clearly

⁵⁶ *The River*, DVD, directed by Mark Rydell (1984; USA: Universal Pictures, 1984); *Places in the Heart*, DVD, directed by Robert Benton (1984; USA: TriStar Pictures, 1984); *Country*, DVD, directed by Richard Pearce (1984; USA: Touchstone Films, 1984).

⁵⁷ Thomas Adams, "The Servicing of America: Political Economy and Service Work in Postwar Southern California," (unpublished dissertation, University of Chicago, 2009).

convey emotion under the gaze of cameras was an essential skill that Democrats needed to gain support for the Farm Bill.⁵⁸

The televised hearing was a strong rebuke to the Reagan administration's arguments that the government had no place in interfering in the free market. The Farm Crisis, according to Field, Spacek, and Lange, was not a mere market adjustment. Instead, the crisis threatened the very core of American values. In her tearful testimony, Jessica Lange argued that "Family farms, owned and controlled by those who labor to produce food for this nation and whose connection to the land is an emotional one has created a unique environment and culture across this country." Drawing a direct connection to the virtuous producer, Lange rhapsodized that without these family farms:

[T]here will be no trace of the traditional American character Ralph Waldo Emerson described when he spoke of farming: "This hard work will always be done by one kind of man; not by scheming speculators, nor by soldiers, nor professors, but by men of endurance—deep chested, long-winded, tough, slow and sure, and timely."

The family farmers were the personification of America. Therefore, the federal government must support farmers with a "1985 farm bill that would guarantee better price supports in combination

⁵⁸ For an analysis of Reagan's blending of acting and politics, see James Hoberman, *Make My Day: Movie Culture in the Age of Reagan* (The New Press, 2019); Heyu Xiong, "The Political Premium of Television Celebrity," *American Economic Journal: Applied Economics*, Vol. 3, No. 4 (October 2021), 1-33; J. Jeffery Auer, "Acting like a President; or, What Has Ronald Reagan Done to Political Speaking?" Michael Weiler and W. Barnett Pearce, eds., *Reagan and Public Discourse in America* (University of Alabama Press, 1992), 95.

with supply management on the part of the farmers.” Direct government action was necessary “because these farmers are our hope” in trying times.⁵⁹

Jessica Lange explicitly challenged the morality of the Reagan administration’s free market ethos. Lange concluded that

If this administration continues on the path it has determined it will cause irreparable damage across the homeland of America. If David Stockman's response to the farm crisis is: “We have too many farmers.” And Ronald Reagan lamely jokes that it's the farmers who should be exported. Or that farm bankruptcies and foreclosures are part of the solution to inflation, then [America] has failed.

Most importantly, the Farm Crisis represented how America was to respond to “a question of values.” Was the country “willing to allow the last remnants of our heritage to disappear” or “see it systematically eradicated by an economic power structure that views small farming as obsolete?” “Is economic feasibility” represented by the free market ethos, “the only true measure of a culture’s value?”⁶⁰

The testimony had a powerful, and unexpected, consequence. Bob Dylan, inspired by the actresses’ description of the dilemma of the family farmer, quipped during his performance at Live Aid in July 1985 that “I hope that some of the money ... [can be used] to pay the mortgages on some of the farms and, the farmers here, owe to the banks.” A month later, Willie Nelson,

⁵⁹ *Congressional Record*, Jessica Lange Testimony, House Democratic Caucus Task Force on Agriculture, *Sally Field, Jane Fonda, Jessica Lange, and Sissy Spacek Speak On The Farm Crisis*, 99 Cong., 1 sess., 131, No. 60 (May 9, 1985), S 5727.

⁶⁰ *Congressional Record*, Jessica Lange Testimony, House Democratic Caucus Task Force on Agriculture, *Sally Field, Jane Fonda, Jessica Lange, and Sissy Spacek Speak on The Farm Crisis*, 99 Cong., 1 sess., 131, No. 60 (May 9, 1985), S 5727.

Neil Young, and John Mellencamp announced plans for a “Farm Aid” benefit concert. The concert, held in Champaign Illinois, was a twelve-hour event broadcasted live on cable television to “raise awareness about the loss of family farms and to raise funds to keep farm families on their land,” that brought the plight of the mid-level farmer into living rooms across the country. Throughout the broadcast, musicians and actors encouraged viewers to call a toll-free 800 number and donate directly to needy “family farmers.”⁶¹

Sissy Spacek and Jessica Lange used the broadcast to directly appeal to American viewers. According to Spacek, “[t]here is no braver or more hopeful act than risking everything on fragile seeds in hostile dirt to feed strangers in distant cities.” Farming was “an act of total commitment to people.” Because the farmers had given so much to produce America’s food, Spacek could not “believe that we will abandon [the American] spirit and allow our farmers to parish.” These farmers were not profit-driven speculators. Rather, Spacek cast them as “Victims of their own generosity, and hopefulness,” who went into debt in order to feed the nation. The farmers were motivated by a preindustrial work ethic and moral responsibility to produce goods that feed the nation. Thus, it was the farmers’ virtue that had led to their demise. Because of this sacrifice, Spacek argued “I cling to the hope that this nation will realize the gravity of the situation and move together to preserve the farms and the farming people of this magnificent land.”⁶²

Jessica Lange, echoing her congressional testimony, appealed to American cultural values. Lange painted a grim picture of the American Midwest. She emphasized that that “roughly 280,000” farmers had left the land “in the last three years,” effectively making the loss of the family farmer a present-day, rather than historic, circumstance that mirrored

⁶¹ Live Aid, *Bob Dylan Performs*, July 1985; *Farm Aid Televised Broadcast*, September 22, Nashville Network, 1985; “‘Farm Aid’ Concert on Roll; Bob Dylan, Beach Boys Sign On,” *Chicago Sun Times*, August 18, 1985.

⁶² Sissy Spacek, Live Aid Broadcast, September 22, 1985.

deindustrialization that was turning the Midwest into the Rustbelt.⁶³ This dramatic loss, now contemporized, drove Lange to state that the country was faced with “a question of values.” Were Americans “willing to passively allow the last remnants of our great cultural heritage to disappear?” Central to Lange’s imagery was the concept that the family farmer was more than a simple tiller of soil. They represented the cultural heritage of America: a democratic, hard-working, independent people who served the greater good by providing the nation with food.⁶⁴

Again, Lange contrasted the farmers’ moral work ethic to the anxiety of 1980s America. Lange, eliding the root causes of the Farm Crisis, argued that unlike Wall Street bankers, farmers did not speculate in the land for increased profits. Instead, farmers represented a pre-industrial work ethic that had become central to American culture; they partook in masculine labor to produce goods that benefited all Americans. Their survival was a matter morality, not economics. Thus, without help, “a whole page of American history will be lost forever.” By supporting government action to help farmers, the average American “can keep America growing.” Continued progress of America, for Lange, was directly connected to the preservation of the family farmer.⁶⁵

In 1985, the state of American farming, once hidden in obscure USDA reports and congressional hearings, leapt from American television sets and popular magazines. Hugh Sidey, longtime columnist for *Time* magazine, succinctly captured the sentiment of millions of Americans. During a time of plenty—“rich harvests” guaranteed that food was abundant and cheap—the Farm Crisis represented “something terribly important in American history.” The crisis was not one of tangible commodities. It was “a cultural crisis unique in our history” that

⁶³ The most dramatic loss in the number of American farmers occurred between 1939-1970, with the total number of farms (in thousands) reduced from 6,631 to 2,902. See U.S. Department of Agriculture, Economic Research Service, *Economic Indicators of the Farm Sector: National Financial Summary*, 1986.

⁶⁴ Jessica Lange, Live Aid Broadcast, September 22, 1985.

⁶⁵ Jessica Lange, Live Aid Broadcast, September 22, 1985.

reached “beyond bank loans and Government subsidies.” It was a crisis “in people’s hearts.” If farmers, who were “sustained by the soil, which is the oldest way of life Americans know,” were allowed to disappear, then the cultural soul of America itself would disappear.⁶⁶

Americans by-and-large agreed with this depiction of farmers and the Farm Crisis. A New York Times-CBS survey “found that more than half of the public is convinced that the farmers face serious economic problems and want to see a boost in federal spending to help them.” The poll found that a majority of Americans endorsed farmers as virtuous as “58 percent of the public agreed that ‘farm life is more honest and moral than life in the rest of the country.’”⁶⁷ Another New York Times poll found that in direct rebuke to the Reagan administration’s agenda to reduce government spending, the “American public [was] not eager to see cuts in spending on programs to aid farmers . . . as 65 percent said it would be a bad idea to spend less on farm aid so as to reduce the Federal deficit.”⁶⁸ In a direct counter to the free market ideal of small government and low taxes, “70 percent [of Americans] believe that the federal government has a clear obligation to save financially distressed farm families,” and “55 percent of those polled said they would be willing to pay more taxes if that would help farmers save their land.”⁶⁹ Unlike Medicare and Social Security, farm aid was not a government expenditure that most Americans thought that they would one day use. Thus, the fact that a majority of Americans wanted to raise their taxes to support less than three percent of the population must be recognized as a direct counter to Reagan’s free market rhetoric.

⁶⁶ Hugh Sidey, “The Presidency: Cries of The Heart,” *Time*, 128, Issue 6, August 11, 1986, 15.

⁶⁷ “Who Wants to Help the Farmers?,” *U.S. News & World Report*, March 24, 1986, 82.

⁶⁸ Seth King, “Reagan’s Farm Bill Seeks Market Basis for Aid, Block Says,” *New York Times*, January 23, 1985.

⁶⁹ “Who Wants to Help the Farmers?,” *U.S. News & World Report*, March 24, 1986, 82; *Congressional Record*, House Democratic Caucus Task Force on Agriculture, *Sally Field, Jane Fonda, Jessica Lange, and Sissy Spacek Speak On The Farm Crisis*, 99 Cong., 1 sess., 131, No. 60 (May 9, 1985), S 5727.

The support for continued farm welfare by the American general public, even if increased taxation was necessary, warrants further attention. Free markets were central to the Reagan Revolution. The hallmarks of Reagan's first term include the largest tax cuts in American history, a symbolic turn against organized labor with the PATCO strike, and broad deregulation. It is important to remember what these moves were intended to do: revitalize American manufacturing. By 1985 it was increasingly clear that these policies were not working as intended.⁷⁰ In fact, congressional testimony characterized the statistic that service industry employment far outpaced manufacturing as "the most important economic transformation since the Industrial Revolution" in the previous year.⁷¹ For many Americans, the free market was not an end of itself, but a means to counter deindustrialization to revitalize production, and thus labor. The Farm Crisis clearly illustrates this fact. The market was understood as a threat to both labor and production as American farmers could not compete within a global economy without government support. Thus, the free market had to be supplanted by direct government aid. What made government policy legitimate was not whether it adhered to some strict sense of free market ethos, but whether said policies supported the virtuous producers of American society.

The overwhelming public support to help the family farmer directly impacted the 1985 Farm Bill. The same Reagan administration that had fought against any and all subsidies in 1981, and vetoed a previous draft of the bill, kept in place acreage reduction programs that paid corn and wheat farmers not to produce. Direct government subsidies to farmers were expanded,

⁷⁰ Much of the debate surrounding the Tax Reform Act of 1986 centered on how tax cuts, specifically the Accelerated Cost Recovery Act, were not reviving American manufacturing. See Eugene Steuerle, *The Tax Decade: How Taxes Came to Dominate the Public Agenda* (The Urban Institute, 1992). Congruently, many New Democrats recognized that the future of American economy would center on technology and information, rather than heavy manufacturing. See Geismer, *Don't Blame Us*, 251-79; Robert Reich, *The Next American Frontier* (Penguin Books, 1983); Daniel Bell, *The Coming of the Post-Industrial Society* (Basic Books, 1973).

⁷¹ Ronald Shelp, "Testimony before the Subcommittee on Economic Stabilization," June 8, 1984. Congress of the United States, Service Industries: The Future Shape of the American Economy, 98 Cong., 2 Sess., June 8, 12, 14, and 28, 1984 (Washington D.C., 1984), 94.

increasing farmers' incomes at higher levels through the 1988 fiscal year. The bill passed with bipartisan support in senate with 55 votes (22 Democrats; 33 Republicans).⁷² Although the total "yea" count was below a veto-proof majority, Reagan, ever the mindful politician, understood the broad public support that the imagery of struggling family farmers had created, and did not veto the bill. Instead, in the same speech where he jibed "I've always felt the nine most terrifying words in the English language are: I'm from the Government, and I'm here to help[.]" the president boasted that "[i]n order to see farmers through these tough times, our administration has committed record amounts of assistance, spending more in this year alone than any previous administration spent during its entire tenure. No area of the budget, including defense, has grown as fast as our support for agriculture." President Reagan's free market policies had failed to revive American manufacturing. However, Reagan could take credit for saving the symbol of American virtuous production as he concluded by stating that "America's farmers should know that our commitment to helping them is unshakable. And as long as I am in Washington, their concerns are going to be heard and acted upon."⁷³ The federal government had saved the family farmer.⁷⁴

Or had it? Before Jessica Lange and Sissy Spacek testified, before Farm Aid beamed the plight of the family farmer into living rooms across the country, and before popular magazines demanded that something be done to protect the soul of America, a long article entitled "Cut Costly Myths: The Family Farm is Doomed" appeared in the *Washington Post*. This article was a succinct summary of a full report that the U.S. Congress ordered from several agricultural

⁷² U.S. Congress, Senate, Committee on Agriculture, *Food Security Act of 1985*, P.L. 99-198 "1985 U.S. Farm Bill", 99 Cong., 1 sess., December 23, 1985; "How the Senate Voted on Farm Bill," *New York Times*, December 19, 1985.

⁷³ Ronald Reagan, "The President's New Conference," (speech, Washington, DC, August 12, 1986), University of California Santa Barbara American Presidency Project, <http://www.presidency.ucsb.edu/ws/index.php?pid=37733>.

⁷⁴ "Farm Bill Granted a Limited 'Win' to All Sides," *CQ Almanac 1985*, 41st ed. (Washington, 1986), 517-539; Eleanor Clift, "Reagan Signs History's Most Costly Farm Bill," *Los Angeles Times*, December 24, 1985.

foundations. In it, Susan Sechler, the director of The Food and Agriculture Policy Project, boldly asserted that “tinkering with outdated farm policies will not bring back yeoman agriculture. If we’re to cope with the problems posed by modern farming, the government must recognize it as the business enterprise it has become.” With “farm output already concentrated in remarkably few hands . . . it stretches the imagination to think of farming as a ‘way of life’ that government programs should try to ‘preserve.’” The family farmer of popular imagination was, in fact, a savvy businessperson by the 1980s. No amount of government support could bring back the mythical yeoman farmer.⁷⁵

Though Sechler recognized farming as a business, she did not agree with the Reagan administration’s approach. Countering Reagan’s plan to “gut the programs and make agriculture more ‘market-oriented,’” Sechler stated that “[a]ll of the evidence suggests, however, that the markets cannot possibly absorb current production levels for commodities now in surplus.” Neither side of the debate accurately reflected the actual situation. Simply continuing governmental farm programs that dated back to the New Deal or shifting to the free market would not remedy the roots of the Farm Crisis.⁷⁶

In order to address the full problem, Sechler argued that the complexity and difficulty of the situation must be recognized. Mid-level farmers, numbering 570,000, who earned between \$40,000 to \$200,000, produced “40 percent of the nation’s food” in 1985. “These farmers are to agriculture what the ‘rust-belt’ blue-collar workers are to manufacturing: an endangered class within a rapidly changing economy.” Therefore, government policies must shift and focus on directing help to those specific farmers. Benefits to “very large farmers whose sales exceed a

⁷⁵ Susan Sechler and Ken Cook, “Cut Costly Myths: The Family Farm is Doomed,” *Washington Post*, January 20, 1985, C1.

⁷⁶ Susan Sechler and Ken Cook, “Cut Costly Myths: The Family Farm is Doomed,” C1; U.S. Department of Agriculture, Economic Research Service, *Issues in Agricultural Policy: New Approaches to Financing Long-Term Farm Debt*, AIB-511 (Washington D.C., March 1987).

specified amount ([more than] \$200,000 a year) should be cut.” Medium-sized farmers should be targeted for benefits, but the industry should be closely regulated. The government and American citizens must recognize that family farms will “not produce the bulk of the country’s food.” However, Sechler cogently argued that it is in the best economic and societal interest to aid these farmers through the Farm Crisis and to help them to find a “niche raising fresh or specialty crops on farms on the fringes of suburbia.” Only then can the family farmer survive and truly contribute to the American economy.⁷⁷

The succinct and comprehensive recommendations of Sechler and her colleagues were ignored. Instead, the debate was framed around the competing ideologies to save the idealized virtuous producer embodied by the family farmer. The American public responded to the emotional call to save a symbolic cultural cornerstone, pushing Reagan to continue outdated farm policies. Nothing had been done to fundamentally alter the nation’s farm program that had failed to prevent the loss of family farmers far before the 1980s.

Without reform efforts, legislation instead continued to directly bail out farmers. In 1986, Congress further aided struggling farmers by amending the Bankruptcy Code. Indebted farmers could reduce the principal owed on their farm mortgage, extend the length of their outstanding loan, and even receive a lower interest rate. Furthermore, the amended law gave farmers the ability to negotiate for modifications on their loan even without declaring bankruptcy.⁷⁸

By 1987, the full cost of the nation’s farm programs exceeded \$30 billion a year. Because the programs remained unaltered, ten percent of subsidies went to farms with incomes greater

⁷⁷ Sechler and Cook, “Cut Costly Myths: The Family Farm is Doomed,” C1. These findings are more comprehensively explained in the detailed report produced for Congress. See William A. Galston, *A Tough Row to Hoe: The 1985 Farm Bill & Beyond* (Hamilton Press, Roosevelt Center for American Policy Studies, The Food and Agriculture Project, 1985).

⁷⁸ Bankruptcy Judges, U.S. Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088; U.S. General Accounting Office, “Farm Finance: Participants’ Views on Issues Surrounding Chapter 12 Bankruptcy,” Briefing Report on Congressional Requestors, GAO/RCED-89-142BR, May 1989, available at <http://archive.gao.gov/d25t7/138655.pdf>.

than \$500,000; seventy percent went to farms earning \$100,000 or more. Only thirty-one percent of payments went to mid-level farmers with sales less than \$100,000. Furthermore, government payments increased with income. Farms earning \$500,000 received, on average, \$37,499 from the federal government while those earning less than \$40,000 received an average of only \$447. Writing in 1986, Jay Walljasper of *The Nation* lamented that “[n]early everyone agrees that Reagan’s farm program, which so far has cost more than the combined farm expenditures of every president from Roosevelt to Carter, is a disaster.”⁷⁹ Without a spotlight on fundamental reform, the government continued to support the highest-earning farmers. The small family farmers of the public consciousness, to the extent that they actually existed, were not sufficiently aided by the 1985 Farm Bill.⁸⁰

The invocation of the virtuous producer obscured the complexity of the Farm Crisis. Long standing problems of wealth concentration, joblessness, and ineffective political economic policies were not addressed. Without proper agricultural reform, many rural communities continued to stagnate and decline in the thirty years since the Farm Crisis. Farming has continued to automate, leading to further concentration of wealth as self-driving tractors and drones allow one farmer to cultivate ever-larger acres of land.⁸¹

⁷⁹ Jay Walljasper, “Farmers and the Left: Little Cell on the Prairie,” *Nation*, October 25, 1986, 403.

⁸⁰ U.S. Department of Agriculture, *Economic Indicators of the Farm Sector: National Financial Summary* (Washington, 1985), 46, 52; U.S. Department of Commerce, Bureau of the Census, *Statistical Abstract of the United States* (Washington, 1986), 307; Luttrell, *The High Cost of Farm Welfare*, 114-20.

⁸¹ Taylor Dobbs, “Farms of the Future Will Run on Robots and Drones,” *NOVANEXT*, July 9, 2013, <http://www.pbs.org/wgbh/nova/next/tech/farming-with-robotics-automation-and-sensors/>; U.S. Department of Agriculture, Economic Research Service, Economic Bulletin Number 164, *America’s Diverse Family Farms 2016 Edition* (Washington D.C., 2016); Sam Robinson, “New Census Data Shows Decrease in the Number of Farms, Growth in Average Farm Size,” *Investigatamidwest.org*, February 20, 2014, <https://investigatamidwest.org/2014/02/20/new-census-data-shows-decrease-in-the-number-of-farms-growth-in-the-average-farm-size/>.

The long-term effect of deindustrialization is the obvious example of how post-1984 politics have failed many Americans. As with farming, the rhetoric that the free market would provide for American industrial jobs never came to be. Deindustrialization only grew more rapidly through the 1980s and 1990s. Although these Americans were also the symbol of virtuous production, there was no single policy, like a farm bill, that could galvanize support for direct government aid. The New Economy has not taken hold in vast swaths of the American landscape. Again, as with the Farm Crisis, dramatic reform to directly provide for these Americans has not addressed core problems. Free trade, though providing cheaper goods for the American consumer, has done nothing to help areas that once were central for industrial production. Retraining and education has mostly been underfunded and inadequate.⁸²

The Farm Crisis, however, represents more than just failed agricultural policy. The Reagan Revolution was not the sole arbiter in defining the contours of American neoliberalism. Rather, it was only after the Reagan administration's ideas and rhetoric were challenged and modified after 1984 that the formulation of how neoliberalism would function concretized in the American political economy for decades to come. Free market rhetoric continued to meet resistance when it was applied to people and institutions that Americans believed should be protected. For instance, the American public consistently and vocally opposed numerous attempts to privatize Social Security and Medicare.⁸³ Yet, like with the Farm Crisis, the policies

⁸² Joseph Stiglitz, *Globalization and Its Discontents* (W.W. Norton & Co., 2002); Robert Reich, *Saving Capitalism: For the Many, Not the Few* (Knopf Doubleday, 2016); Geismer, *Don't Blame Us*, 251-87; Paul Krugman, "Trade and Tribulation," *New York Times*, March 11, 2016, https://www.nytimes.com/2016/03/11/opinion/trade-and-tribulation.html?_r=0; William Greider, "Paul Krugman Raises the White Flag on Trade," *Nation*, March 14, 2016, <https://www.thenation.com/article/archive/paul-krugman-raises-the-white-flag-on-trade/>; Michael Hirsh, "Economists on the Run," *Foreign Policy*, October 22, 2019, <https://foreignpolicy.com/2019/10/22/economists-globalization-trade-paul-krugman-china/>.

⁸³ Thomas P. O'Neill Jr., "Campaign to Save Medicare/Medicaid" 1984 From Edwin Meese Files, Box 19, file: Campaign '84—Democratic, Ronald Reagan Library in Meg Jacobs and Julian E. Zelizer, *Conservatives in Power: The Reagan Years, 1981-1989, A Brief History with Documents* (Bedford/St. Martin's Press, 2011), 118-20; William A. Galston, "Why President Bush's 2005 Social Security Initiative Failed, And What That Means for the

of New Democrats and Republicans have failed to take into full account the complexity of the economic changes that occurred since the Volcker Shock.

The chapters ahead will analyze how the Volcker Shock ushered in the transition from industrial to financial production. The Farm Crisis will prove to be an informative model of how crisis after crisis of the late 1980s played out: a foundational aspect of the postwar political economy became volatile as result of the Volcker Shock; a resulting commodity bubble implodes leading to economic disaster. Congress then acts through legislation to save a specific producer. The key difference throughout, however, is the shift from industrial producer, like the farmers explored above, to a financial producer. By the end of the decade, a new virtuous producer will replace the humble family farmer—the Chicago futures trader.

This shift underscores the fact that the era is not necessarily dominated by a “small government” philosophy. Rather, Congress often effectively used federal power—and funding—to manage catastrophe. The market was never truly free of government interference when disaster struck. There was, however, a fundamental change that paralleled the Farm Crisis: the shift from supporting the demand side of the economy to supply side, represented by the growing support for financial institutions by the state, as labor power precipitously declined.

It is important to underscore how chaotic the transition was. There was no masterplan—neoliberalism, as we currently understand it—did not emerge a fully formed system with the inauguration of Reagan. In fact, just the opposite. Reagan’s presidency is highlighted by glaring contradiction and overt use of federal power. Rhetoric behind small government and the efficacy of the free market is often undercut by economic disaster and federally funded bailouts. Again,

Future of the Program,” *New York University’s John Brademas Center for the Study of Congress and the Organizational Performance Initiative The Legislating for the Future Project*, (NYU Press, 2007), <https://wagner.nyu.edu/files/performance/bush2005.pdf>.

as the Farm Crisis illustrates, bipartisan coalitions often pushed back against the most extreme end of Reaganism throughout the 1980s.

The next two chapters highlight the confusion, contradiction, and economic chaos of the era. Two pillars of the postwar economy—taxation and home mortgages—were remade. Reagan’s 1981 tax cuts have come to define the era. However, these tax cuts were recognized as failures almost immediately. In an unexpected turn, it was the New Democrats that ushered in tax reform that attempted to both simplify the tax code, but also to effectively fund the new industries of growth that would, in theory, support new American jobs and income. Congruently, deregulation and Reagan’s 1981 tax reform bill effectively funded speculation in the savings and loan industry, threatening access to homeownership for millions of Americans. A bipartisan group of Congressmen would set out to save this key financial industry, creating unexpected and dramatic results that have reverberations through the 2008 mortgage crisis.

Chapter 2

Acquiescence or Reform?: The Tax Reform Act of 1986 and the Sunrise Politics of the New Democrats

“The fact is that liberalism is at a crossroads. It will either evolve to meet the issues of the 1980s or it will be reduced to an interesting topic for PhD-writing historians.” Paul Tsongas, the freshman Senator from Massachusetts, did not parse his words in the summer of 1980. Tsongas “shocked the convention of the Americans for Democratic Action (ADA) with a doomsday denunciation of orthodox LBJ liberalism as irrelevant to the economic constraints of the '80s.”¹ The truth of this message crystalized months later as Ronald Reagan entered the White House.² *New York Times* columnist Anthony Lewis stated on the “MacNeil/Lehrer Report” that the Democratic Party had been “swept away” and were now a “party without an idea.... A lost party.” *Chicago Sun-Times* columnist Morton Kondracke piled on, asserting that the election of Reagan was a “conservative revolution not principally directed at the person of Jimmy Carter” but also “a repudiation of Great Society liberalism.”³

Scholarship on the rise of postwar Conservatism has given proof to Kondracke’s postelection night claim. We now understand that there was no one singular motivation behind this sea change. The rise of the Sun Belt corresponded with the development of evangelical, pro-

¹ Curt Suplee, “The Tsongas Liberalism,” *Washington Post*, September 23, 1981, <https://www.washingtonpost.com/archive/lifestyle/1981/09/23/the-tsongas-liberalism/ef2a3600-df5b-43cf-876c-149a96932b57/>.

² “Bunker Liberalism: Find Realistic Solutions for Tomorrow’s Problems,” *Washington Post*, November 9, 1980, <https://www.washingtonpost.com/archive/opinions/1980/11/09/bunker-liberalism-find-realistic-solutions-for-tomorrowss-problems/50c9abfd-50b2-4eef-9c6a-b3f78af4d468/>.

³ “The MacNeil/Lehrer Report; 6093; Election Fallout: The Parties,” 1980-11-05, NewsHour Productions, American Archive of Public Broadcasting (GBH and the Library of Congress), Boston, MA and Washington, DC, accessed March 17, 2021, <http://americanarchive.org/catalog/cpb-aacip-507-w37kp7vk13>; Randall Rothenberg, *The Neo-Liberals: Creating the new American Politics* (New York: Simon and Schuster, 1984), 15-16.

market, grass-roots organizing centered on reducing taxes and limiting federal power.⁴ Think tanks, academic theory, and political action groups, supported by business elites, economists, and intellectuals, turned critique of the New Deal and Great Society policies in to political action.⁵ With the election of Reagan, free market ideology ruled. Neoliberalism became central to Republican political ideology throughout the 1980s, and was normalized by President Clinton’s declaration that “the era of big government is over” a decade later.⁶

This assessment reinforces the idea of acquiescence to the Reaganite ideology by Democrats throughout the 1980s. In truth, new ideas abounded within the Democratic Party to attend to both the political gains and policy failures of Reagan’s his first term through the 1980s. A cohort of young congressional representatives and thinkers began to incorporate free market ideas with a recognition that the American economy of yore—one of heavy industrial manufacturing—would not return. Government intervention into the marketplace had to be remade.⁷

Careful examination of tax policy brings this dynamic to light. Most research on this era is concerned with the implementation of neoliberal ideology. While this important work has done much to further our understanding of the epoch, how ideology transformed into legislation remains vague. Analyzing a moment of intense policy debate illuminates the nuance of material

⁴ See for example, Elizabeth Tandy Shermer, *Sunbelt Capitalism: Phoenix and the Transformation of American Politics* (University of Pennsylvania Press, 2013); Darren Dochuk, *From Bible Belt to Sun Belt: Plain-Folk Religion, Grassroots Politics, and the Rise of Evangelical Conservatism* (WW Norton, 2011); Lisa McGirr, *Suburban Warriors: The Origins of the New American Right* (Princeton University Press, 2001).

⁵ Philip Mirowski & Dieter Plehwe eds., *The Road from Mont Pelerin: The Making of the Neoliberal Thought Collective* (Harvard University Press, 2009); Angus Burgin, *The Great Persuasion: Reinventing Free Markets since the Depression* (Harvard University Press, 2012).

⁶ Gary Gerstle, *The Rise and Fall of the Neoliberal Order: America and the World in the Free Market Era* (Oxford University Press, 2022), 152-88. For Gary Gerstle, Bill Clinton’s presidency mirrors Eisenhower’s in that they both continued the policies of the previous presidents (Reagan and FDR), thus cementing the political order for years to come.

⁷ Bill Bradley, *The Fair Tax* (Pocket Press, 1984); Paul Tsongas, *The Road from Here* (Knopf, 1981); Lester C. Thurow, *The Zero-Sum Society: Distribution and the Possibilities for Change* (Basic Books, 1980); Gary Hart, *A New Democracy: A Democratic Vision for the 1980s and Beyond* (W. Morrow, 1983); Daniel Bell, *The Coming of the Post-Industrial Society* (Basic Books, 1973).

change. While Reagan and other Republican supply-siders advocated free markets and low taxation, they did not abandon the usefulness of the federal government in shaping the domestic economy. In fact, the key contention between Republicans and Democrats regarding corporate taxation through the early to mid-1980s was not whether government had a role to play, but how the federal government would incentivize domestic investment. Low taxation was not a hands-off-approach to investment. Just the opposite, low taxes were meant to induce investment back into domestic manufacturing. Conversely, Democrats argued that, when left alone, private investment would not necessarily go to domestic endeavors. Instead, New Democrats argued for a “supply-side liberalism” where the government remained essential to direct investment into domestic operations.⁸

The drafters of the Tax Reform Act of 1986 attempted to address how the interplay between the financialization of the U.S. economy and the effects of Reagan’s 1981 tax bill created economic disparity. When put into practice, the Reagan administration’s supply-side efforts to remake manufacturing fueled deindustrialization and increased inequality. Although Reagan’s 1981 tax legislation attempted to push investment back into heavy manufacturing through a process known as Accelerated Cost Recovery Schedule (ACRS), investors and corporations used their tax savings in speculative ventures, from real estate domestically (which will be explored in the next chapter), to factory building abroad. Conversely, New Democrats recognized the failure of the private marketplace and advanced solutions focused on ending incentives for speculation and other forms of marketplace corruption. Furthermore, making the tax rate “fair” by ending various loopholes, New Democrats argued that their tax policy would use free market dynamics to induce investment into emerging “sunrise industries” of research

⁸ Brent Cebul, “Supply-Side Liberalism: Fiscal Crisis, Post-Industrial Policy, and the Rise of the New Democrats,” *Modern American History* No. 2 (2019), 136-164.

and technology. In total, tax reform would be used to address inequality and create opportunities in the new American economy.⁹

The passage of the Tax Reform Act of 1986 represents a hinge moment for the reshaping of the Democratic Party. After two presidential defeats, Democrats sought create a new political-economic philosophy that embraced the New Economy based on finance, technology, and research to counter Republican inroads with the general electorate. The political-economic strategy behind the 1986 bill became the playbook for the Democratic Party moving forward, finally coming to culmination with the election of Bill Clinton in 1992.

Reagan's successful 1980 campaign begat the "Reagan Revolution." Along with the presidency, Republicans gained twelve seats in the Senate (resulting in their first majority in over twenty-five years), and shrank the Democratic majority in the House. Reagan's electoral success has defined the narrative of the era. However, details of policy debates illuminate a more complex picture where new ideas abounded in Democrat legislatures. Instead of defeat, what occurred during Reagan's first term was, according to Arizona Governor Bruce Babbitt, "a kind of struggle on for the heart and soul of the Democratic Party."¹⁰

In 1980, a group of economic thinkers and young politicians began to promote policies that accounted for the dramatic economic shifts that occurred through the 1970s. Economist Lester Thurow of MIT stated that "The American problem is not returning to some golden age of economic growth."¹¹ Robert Reich, a young economist at Harvard, advanced Thurow's argument and proposed that America was then entering a new

⁹ Bradley, *The Fair Tax*.

¹⁰ Rothenberg, *The Neo-Liberals*, 45.

¹¹ Thurow, *The Zero-Sum Society*, 8.

economic frontier based on a “new postindustrial paradigm” where American jobs would transition from “high-volume mass-production economy of the industrial era to an economy based on information and high technology.”¹² A group of young politicians labeled New Democrats—Gary Hart, Richard Gephardt, Michael Dukakis, Paul Tsongas, and Bill Bradley to name a few—used the ideas of these economists to develop policy that would address the new economy.¹³

The central problem for Thurow, Reich, and New Democrats was that the transition from an economy centered on long-term return on investment to a short-term return on equity hallowed out the American labor market. Reagan attempted to address this problem with tax cuts. Soon after becoming president, Reagan made the promises of the campaign trail policy by signing perhaps his most influential piece of legislation in his first year in office, the Economic Recovery Tax Act of 1981 (ERTA81).¹⁴ Famously, the bill lowered the top tax rate from seventy to fifty percent, the bottom rate from fourteen to eleven percent, and capital gains taxes from twenty-eight to twenty percent.¹⁵

The 1981 tax cuts were based on the theory of supply-side economics. Lower taxes, it was argued, lead to increased private savings. Personal savings would then combine with corporate investment, spurred by the Accelerated Cost Recovery System (ACRS), also included in the bill. The ACRS increased deductions allowed for depreciable assets to alleviate the cost of modernizing and rebuilding American manufacturing facilities. Newly built industrial plants

¹² Rothenberg, *The Neo-Liberals*, 52; Robert Reich, *The Next American Frontier* (Penguin Books, 1983).

¹³ Rothenberg, *The Neo-Liberals*, 17-25.

¹⁴ Monica Prasad, “The Popular Origins of Neoliberalism in the Reagan Tax Cut of 1981,” *Journal of Policy History*, Vol. 24, No. 3, 2012.

¹⁵ U.S. Congress, House, *Economic Recovery Tax Act of 1981 (ERTA81) Act of 1981*, HR4242, 97th Cong., 1st sess., introduced in House July 23, 1981, <https://www.congress.gov/bill/97th-congress/house-bill/4242>.

would increase productivity, job growth, and profits.¹⁶ Government deficits from lowered tax revenue would be offset by dramatic reductions in federal spending, especially on welfare. In total, the malaise of the 1970s would end as American greatness would be remade through a dramatic revival in manufacturing employment. Exports would again be used to offset the increasing trade deficit—another sign of American economic downfall—and American made goods would reclaim the mantle from Germany and Japan as the pinnacle of engineering.¹⁷

This vision did not come to pass. However, the long-lasting effect of ERTA81 on the American political economy cannot be understated. Cutting the individual tax rate remains the central policy of the Republican Party. As such, most critical studies of 1980s tax reform remain centered on the political process and long-term effects of these low tax rates.¹⁸

However, this analysis treats these tax cuts as a static action: they were implemented to secure ever more wealth for better-off Americans. An important, and ignored concept, must be included in any close analysis on early 1980s tax reform. Stagflation in the 1970s had another, insipid effect besides massive job loss. It created a “a new era of fiscal policy” in the early 1980s.¹⁹ Bracket creep caused by inflation moved individuals into higher and higher tax brackets throughout the 1970s.²⁰ Although the real earnings of these Americans remained stagnant, they had to pay an increasing amount to

¹⁶ C. Eugene Steuerle, *The Tax Decade: How Taxes Came to Dominate the Public Agenda* (The Urban Institute Press, 1992), 39.

¹⁷ Jonathan Levy, *Ages of American Capitalism: A History of the United States* (Random House, 2021), 596.

¹⁸ Gerstle, *The Rise and Fall of the Neoliberal Order*, 122. The Tax Reform Act of 1986 is reduced to one sentence: “A second bill, passed during Reagan’s second term, further reduced the highest rate to 28 percent.”

¹⁹ Steuerle, *The Tax Decade*, 2-10, 39-41. Krippner takes this argument as part of her central thesis in *Capitalizing on Crisis*. See Greta R. Krippner, *Capitalizing on Crisis: The Political Origins of the Rise of Finance* (Harvard University Press, 2011).

²⁰ Steuerle, *The Tax Decade*, 22

the federal government. In order to alleviate this deleterious development, tax cuts would have been necessary fiscal policy, no matter which party was elected in 1980.²¹

Although tax cuts were necessary in 1981, Reagan's tax policy was a legislation of extremes. According to economist Eugene Steuerle, who worked both for the Brookings Institute and the Reagan Treasury Department, ERTA81's lowering of both individual tax rates and the policy to allow corporations to write off investments in order to receive massive tax subsidies were concepts that were "adopted during the campaign" for president.²² Neither concept was designed by the Treasury Department, nor rigorously "studied [as] ways to offset the adverse effects of inflation."²³

Monica Prasad's groundbreaking research further illuminates how these tax cuts were politically, not economically designed. Prasad illustrates that the major features of ERTA81 were formed throughout the mid-1970s. Republican Congressman Jack Kemp championed tax reform to combat inflation and generate growth. Business interests were not immediately keen on the idea, but eventually signed on after effective efforts by Kemp and other supply-side adherents. The important lesson from Prasad is that tax cuts were used as an effective means to gain political power. While Kemp may have believed in their utility, the Republican Party in total pursued tax cuts because it offered a simple solution to the complex and vexing problem of stagflation when the Democratic Party had none. Reagan gleefully signed on to the crusade, driven by his hatred of the high tax rates he paid as an actor.²⁴

²¹ Steuerle, *The Tax Decade*, 4, 22-25, 39-41.

²² Steuerle, *The Tax Decade*, 39.

²³ Don Fullerton and Yolanda Kodrzycki Henderson, "Long-Run Effects of the Accelerated Cost Recovery System," *The Review of Economics and Statistics*, Vol. 67, No. 3 (1985), 363-72.

²⁴ Monica Prasad, *Starving the Beast: Ronald Reagan and the Tax Cut Revolution* (Russel Sage Foundation, 2018).

We are left with an interesting conundrum. Inflation had made it necessary to cut some taxes, specifically on the middle and lower classes who were most dramatically affected by bracket creep. The Reagan administration, however, used the detrimental effects of bracket creep to build widespread support for much broader tax reform than was necessary. Additionally, dramatic cuts to individual rates and ever more generous business exemptions became more than a means to correct for bracket creep; tax cuts were central to Reagan's strategy to rebuild the American industrial sector, thus "making America great again."²⁵

It is important to note that using tax breaks to revitalize the economy was not a new strategy in 1981. The Revenue Act of 1964 targeted tax savings to spur investment into the economy. Both corporate rates and the top personal income rate were decreased. The key difference is twofold. First, the corporate cut was relatively low, with no adjustments to appreciation rates. Additionally, the private rate was extremely high at 91 percent, giving a cushion to any cut without a huge impact on government income. Second, and more importantly, the 1964 Tax Cut occurred in an economy which, by 1981, no longer existed.²⁶

The Reagan administration's tax reform policy did not account for how the concept of profit itself had changed by 1981. The postwar growth model was grounded in a theory of return on investment (ROI). In this model, profit from production was based on investing in long term fixed capital—factories. Realizing stable profits through long-term investment in production pushed corporate managers to create stability within the factory floor. Strikes and other forms of labor movements were quelled with living wages

²⁵ Prasad, *Starving the Beast*, 19-38.

²⁶ Julian E. Zelizer, *Taxing America: Wilbur D. Mills, Congress, and the State, 1945-1975* (Cambridge University Press, 1998); Levy, *Ages of American Capitalism*, 595-632.

and demand-side economics. This, of course, is the Fordist political economy that Reagan mythologized throughout his first presidential campaign.²⁷

Stagflation of the 1970s upended this model. Long term investment in fixed capital, and the attending labor force, was no longer profitable. A model centered on the immediate return on equity (ROE) emerged. Industrial manufacturers used their capital to invest in rapid returns in financial investments. This could be achieved through financial products themselves, providing finance to consumers, or even investing in other industries. Short term gains on equity became the engine of profit. David Roderick, the CEO of U.S. Steel, stated that the once great industrial giant was “no longer in the business of making steel.” Instead, it was “in the business of making profit.”²⁸ The logic of heavy industry had shifted, no matter how much taxes were cut.²⁹

Take, for example, three marquee industrial firms: General Electric (GE), Sears, and General Motors (GM). Throughout the nineteenth and twentieth century, all three firms created “captive finance units” that managed installment financing. The creation of installment financing allowed a greater number of Americans the ability to purchase expensive goods. This, in turn, increased demand and revenues. Over time, these captive finance units grew in both size and importance, until they came to characterize banks more than an in-house financing department. GE Capital represents the “quintessential industrial firm-turned bank” that issued private credit cards, financed leveraged buyouts,

²⁷ Jonathan Levy, “Accounting for Profit and the History of Capital,” *Critical Historical Studies* (Fall 2014) 171-214; Lizabeth Cohen, *A Consumer’s Republic: The Politics of Mass Consumption in Postwar America* (Vintage Books, 2003); Robert F. Freeland, *The Struggle for Control of the Modern Corporation: Organizational Change at General Motors, 1924-1970* (Cambridge University Press, 2000).

²⁸ Tracy Neumann, *Remaking the Rust Belt: The Postindustrial Transformation of North America* (University of Pennsylvania Press, 2016), 86.

²⁹ Levy, “Accounting for Profit”; Thomas E. Copeland and Fred J. Weston, *Financial Theory and Corporate Policy* (Addison Wesley, 1979); Perry Mehrling, *Fischer Black and the Revolutionary Idea of Finance* (Wiley, 2005), 131, 274.

and even sold mortgage insurance. Sears Financial and GMAC closely parallel GE Financial as the means of financing products, instead of the products themselves, became the dominate source of revenue.³⁰

This transition is intimately tied with deindustrialization. As industrial firms felt the squeeze of global competition, rising oil costs, and high-waged unionized labor, they began to offshore American manufacturing jobs to lower-wage environments.³¹ Congruently, the American consumer remained the primary market for said manufactured goods. As the historian Louis Hyman elucidates, financialized debt was increasingly used to purchase the once made-in-America products. Thus, American industrial firms maintained or grew in profitability by both selling financing and the product to American consumers, just as millions of industrial laborers faced unemployment. Economic growth in the increasingly financialized economy of the 1980s reflected the profitability of these firms, not the economic condition of middle-class Americans.³²

Robert Reich and Lester Thurow recognized this shift. Reich labeled this new profit strategy “paper entrepreneurialism.”³³ Private industry created “various ploys designed to maintain or increase their firms’ earnings without new productive investment.” This strategy “rearranges industrial assets” to create “short term profits for

³⁰ Krippner, *Capitalizing Crisis*, 28; David Henry, “Corporate America’s New Achilles Heel: Overreliance on Profits from Finance Units May Be Setting Up Companies for a Fall,” *Business Week*, March 28, 2005, 32-34; Danny Hakim, “Detroit Profits Most from Loans, Not Cars,” *New York Times*, July 22, 2004, C1.

³¹ Barry Bluestone and Bennett Harrison, *The Deindustrialization of America: Plant Closings, Community Abandonment, and the Dismantling of Basic Industry* (Basic Books, 1982), 140-192.

³² Louis Hyman, *Debtor Nation: The History of America in Red Ink* (Princeton University Press, 2011), 281-87; Krippner, *Capitalizing on Crisis*, 138-50; Katherine Newman, *Falling From Grace: Downward Mobility in the Age of Affluence* (University of California Press, 1999); “Measuring Economies: The Trouble with GDP-Gross Domestic Product (GDP) is Increasingly a Poor Measure of Prosperity,” *The Economist*, April 30, 2016.

³³ Reich, *The Next American Frontier*, 140-72; Robert Reich, “The Next American Frontier,” *Atlantic Monthly* (March, 1983), <https://www.theatlantic.com/past/docs/issues/83mar/reich.htm>.

the firm.”³⁴ Private industry could no longer be relied upon to use funds to invest in manufacturing, and thus employ Americans. According to Thurow, this new profit model would create “a period of rapidly rising inequalities.”³⁵ Accordingly, “major investment decisions have become too important to be left to the private market alone.”³⁶ Instead, the problems of economic growth facing the nation “demand that government gets more heavily involved in the economy’s major investment decisions” so that “the bottom 60 percent of the population does not fall behind.”³⁷

Reich and Thurow described an easy-to-understand problem and solution to the ailing economy. The emergence of “paper entrepreneurialism”—ROE—fundamentally transformed the connection between profit and manufacturing that was the heart of the Fordist political economy. Private industry could no longer be relied upon to direct investment into long-term strategies that would employ Americans. Thus, the government must take a more active role in determining which industries would be competitive in the structuring economic investment, and create new opportunities for workers.³⁸

New Democrats began to turn Reich and Thurow’s ideas into policy ideas. “Rebuilding the Road to Opportunity: A Democratic Direction for the 1980s” was released in 1982.³⁹ The report, according to Gary Hart, recognized that “Recovery is a meaningless term, as if once we get out of the recession things will be fine. The Structure

³⁴ Reich, “The Next American Frontier,” <https://www.theatlantic.com/past/docs/issues/83mar/reich.htm>.

³⁵ Thurow, *The Zero-Sum Society*, 193.

³⁶ Thurow, *The Zero-Sum Society*, 192.

³⁷ Thurow, *The Zero-Sum Society*, 191, 193.

³⁸ Thurow, *The Zero-Sum Society*, Chapter 8, “Solving the Economic Problems of the 1980s,” 191-214; Reich, *The Next American Frontier*, chapter 8, “Global Change,” 118-139.

³⁹ Democratic Caucus, U.S. House of Representatives. *Rebuilding the Road to Opportunity: A Democratic Direction for the 1980s*, September 1982, Richard A. Gephard Papers, Missouri Historical Society, Box 28, Folder 14, <https://mohistory.org/collections/item/resource:131755> (privately printed, 1982).

has broken down. There can be no return to normalcy.”⁴⁰ A “New Industrial Policy” (NIP) was proposed by Democrats that would attempt to alleviate massive job loss and disinvestment that had accompanied deindustrialization throughout the 1970s and early 1980s.⁴¹

NIP directly countered Reagan’s free market strategy, calling for direct government intervention within corporate investment. This would be primarily done by creating national and regional development banks. Like Herbert Hoover’s Reconstruction Finance Corporation, these banks would use subsidies and federal loan guarantees to slow the contraction of declining industries and to speed the development of emerging industries. Investment itself would be governed by “tripartite councils” of representatives from management, labor, and government. Disinvestment and deindustrialization affected more than the recently unemployed. Entire communities that grew around major industrial factories often lost their primary economic engine. Tripartite councils were promoted as a key piece of industrial democracy that would give communities a greater say in the investment, disinvestment, and reinvestment decisions of firms that directly shaped their lives.⁴²

Unlike Reagan, New Democrats made no promises that NIP would remake industry. The plan was not based on “smokestack chasing,” where states used tax breaks and other financial incentives to lure factories to their communities. Instead, NIP focused on managing the transition to a postindustrial economy. Directed investment would lessen the blow of a factory closure causing massive unemployment in a small town.

⁴⁰ Sidney Blumenthal, “Drafting a Democratic Industrial Plan,” *New York Times*, August 28, 1983, Section 6, page 3.

⁴¹ Reich, “The Next American Frontier,” <https://www.theatlantic.com/past/docs/issues/83mar/reich.htm>; Democratic Caucus, *Rebuilding the Road to Opportunity*.

⁴² Democratic Caucus, *Rebuilding the Road to Opportunity*.

Instead, the federal government would subsidize investment, attempting to make ROI profitable again, while also supporting new areas of economic growth. Furthermore, retraining recently unemployed workers would be subsidized by the federal state. NIP was about “managing the transition,” according to Reich—an attempt to create a controlled landing into a new economic paradigm rather than an economic free fall for the Rustbelt.⁴³

NIP remained controversial throughout the early 1980s.⁴⁴ However, another key reform was embraced by both old guard and New Democrats: tax reform.⁴⁵ First, the tax code would be used to discourage mergers, acquisitions, and other forms of paper entrepreneurialism. Secondly, the overall structure of the tax code would be remade to create a “system that will be perceived as fair.”⁴⁶ Some revenue would need to be raised to fund the expenditures of the new government programs. However, these taxes would be collected from individuals and firms who benefitted from increased government investment in research and development.⁴⁷ Finally, the tax code would be used to invest in the “sunrise industries” that would provide future job growth.⁴⁸ Taken as a whole, tax reform would address inequality and opportunity by eliminating tax loopholes only

⁴³ Rothenberg, *The Neo-Liberals*, 91; Robert Reich, “Making Industrial Policy,” *Foreign Affairs*, Spring 1982, 852; Reich, *The Next American Frontier*, Chapter 10, “Dead-End Labor,” 201-228; Charles P. Alexander, “The New Economy,” *Time* May 30, 1983.

⁴⁴ Charles Schultze, “Industrial Policy: A Dissent” *Brookings Review* (October 1983): 3-12; Philip Trezise, “Industrial Policy Is Not the Major Reason for Japan's Success.” *Brookings Review* (Spring 1983): 13-18.

⁴⁵ Rothenberg, *The Neo-Liberals*, 173; Edward Cowan, “A Democratic Economic Rift,” *New York Times*, May 30, 1983, Section 1, page 36.

⁴⁶ Thurow, *The Zero-Sum Society*, 194; Democratic Caucus, *Rebuilding the Road to Opportunity*; Bradley, *The Fair Tax*.

⁴⁷ Thurow, *The Zero-Sum Society*, 194.

⁴⁸ Alexander, “The New Economy”; Fox Butterfield, “Two Areas Show Way to Success in High Technology Industry,” *New York Times*, July 6, 1982; Ken Banschik, “High-Tech Fever Grabs States, Cities,” *High Technology*, March/April, 1982; “The MacNeil/Lehrer Report: High Tech and the Cities,” 1983-02-02, NewsHour Productions American Archive of Public Broadcasting (GBH and the Library of Congress), Boston, MA and Washington, DC, accessed February 16, 2023, <https://americanarchive.org/catalog/cpb-aacip-507-pg1hh6d06d>; Statement on Tax Policy by Senator Bill Bradley to the Washington Press Club, May 27, 1982.

available to the wealthy and corporations, while also incentivizing investment into the future of job growth in the newly expanding industries of high-technology and research.

In 1981, Senator Bill Bradley (D-NJ), began to put ideas to paper. Described as “a major player in Democratic economic thinking,” Bradley believed that “the key [was] how to get the economy moving again, not how to get new government delivery systems.”⁴⁹ Economic growth, not redistribution, was central to his plan. His “Fair Tax” proposal addressed the shortcomings of Reagan’s tax reform in two key ways. First, all individual rates would be lowered. Poorer Americans would receive tax cuts that addressed the adverse effects of bracket creep from the 1970s—effects that ERTA81 did nothing to alleviate.⁵⁰ Although top rates would also be cut, the plan sought to eliminate nearly all credits, deductions, and exclusions as politically possible. This meant that deductions for secondary home ownership, contributions to individual retirement accounts, and rental properties would be scrapped as charitable giving, primary home mortgage interest, and Social Security would not.⁵¹ Eliminating said loopholes would, in theory, offset the loss of revenue from lowering the top rates. According to Bradley, the Fair Tax would broaden the base of overall taxation, allowing increased revenue collection.⁵² The plan would also eliminate many of ERTA81’s corporate tax cuts and loopholes, thus making corporate America “pay a fair share.”⁵³ In the summer of 1983, Senator Bradley secured Representative Richard Gephardt of Missouri—a leading voice

⁴⁹ Rothenberg, *The Neo-Liberals*, 23, 46.

⁵⁰ Steuerle, *Tax Decade*, 44-45.

⁵¹ Rothenberg, *The Neo-Liberals*, 177; “The MacNeil/Lehrer Report: Simpler Taxes,” 1982-07-07, NewsHour Productions, American Archive of Public Broadcasting (GBH and the Library of Congress), Boston, MA and Washington, DC, accessed February 16, 2023, https://americanarchive.org/catalog/cpb-aacip_507-7h1dj5944b.

⁵² Bradley, *The Fair Tax*.

⁵³ Bradley, *The Fair Tax*, 122-30.

in the “Rebuilding the Road to Opportunity” strategy—as a cosponsor, and submitted his tax plan to the Congressional Budget Office for review.⁵⁴

In total, both the New Industrial Policy and Fair Tax offered a strategy to counter American job loss. Although much of the NIP resembled classic Democratic ideas from the 1930s, the plan identified opportunity for middle class growth in the postindustrial economy. This new economy would operate far differently from the postwar model. Software design, advanced computer-assisted manufacturing, bio-medical research, and other “high-end” service work would replace the factory floor. Silicon would replace smokestacks. These policies, according to Bradley, exemplified how New Democrats were “trying to think through the problems of the eighties” as “traditional Democratic responses really had their origins in the thirties and are not going to meet those problems.”⁵⁵

Like ERTA81, Bradley’s plan was not revolutionary. In addition to using tax cuts to incentivize domestic investment, eliminating “tax expenditures”—cuts and deductions that resemble spending—began in the 1960s.⁵⁶ Using the supply side to induce investment remained a key strategy for southern Democrats throughout the era.⁵⁷ The key difference was not the tactic, but target. The solution for the “problems of the eighties”

⁵⁴ Bradley’s plan became the Bradley-Gephardt bill. “Corporate Financial Statements and the Tax Bill,” Rep. Gephardt, E. 3679, 99th Cong., 2nd sess., *Congressional Record* 132 (October 16, 1986); Jeffrey Birnbaum and Alan Murray, *Showdown at Gucci Gulch: Lawmakers, Lobbyists, and the Unlikely Triumph of Tax Reform* (Knopf Doubleday, 1987), 58. Gephardt would play a pivotal role in shepherding the legislation through the House of Representatives. However, despite his ability to secure votes, Bradley remained the “brains” behind the tax bill. See Birnbaum and Murray, *Showdown at Gucci Gulch*, 30-31, 76-77, 110, 257.

⁵⁵ Rothenberg, *The Neo-Liberals*, 27; Fox Butterfield, “Two Areas Show Way to Success in High Technology Industry,” *New York Times*, July 6, 1982; Ken Banschik, “High-Tech Fever Grabs States, Cities,” *High Technology*, March/April, 1982; “The MacNeil/Lehrer Report: High Tech and the Cities,” https://americanarchive.org/catalog/cpb-aacip_507-pg1hh6d06d.

⁵⁶ Joseph A. Pechman, *Federal Tax Policy* (Brookings Institution, 1987); Herbert Stein, *The Fiscal Revolution in America* (University of Chicago Press, 1969); Julian E. Zelizer, *Taxing America: Wilbur D. Mills, Congress, and the State, 1945-1975* (Cambridge University Press, 1998).

⁵⁷ Cebul, “Supply-Side Liberalism,” 19-21.

required recognizing service and technology as the center of the economy. Where ERTA81 attempted to rebuild, the Fair Tax attempted to reshape.

By 1982, Ted Kennedy, described as the “epitome of traditional liberalism,” embraced New Democrats’ reforms. He stated that “a new industrial policy ... new and simpler tax system ... investment in basic industry, high technology, and microchips” would turnaround the economy and provide opportunity for millions. Investment in the future, not remaking the past, became central for a party still reeling from electoral defeat.⁵⁸

New Democrats were initially confident that NIP would result in electoral victory in 1984. Beginning in 1981, the nation faced the “worst economic downturn since the Great Depression.”⁵⁹ Reagan’s approval rating fell to 35 percent in 1982. Republicans fared poorly in the midterm elections, losing 26 seats in the House. For Democrats, the recession “exposed Reaganomics as a return to the disastrous trickle-down Republican policies that the Great Depression had discredited.”⁶⁰ With the next presidential election under two years away, Democrats believed that Americans would embrace their new economic ideas.

However, the next year wrought a sea change. An economic recovery that began “the longest continual period of peacetime economic expansion ever recorded to that point in American history,” commenced in 1983.⁶¹ The Reagan administration was quick to credit the 1981 tax cuts as the catalyst for the turnaround. In truth, numerous other

⁵⁸ Fred Barnes, “A Few Liberals Sober Up,” *American Spectator*, January, 1982; Rothenberg, *The Neo-Liberals*, 48.

⁵⁹ Tim Sablik, “Recession of 1981-82: Lasting from July 1981 to November 1982, this economic downturn was triggered by tight monetary policy in an effort to fight mounting inflation,” *Federal Reserve History*, Federal Reserve Bank of St. Louis, https://www.federalreservehistory.org/essays/recession_of_1981_82, last accessed January 31, 2018.

⁶⁰ Sean Wilentz, *The Age of Reagan: A History 1974-2008* (Harper, 2008), 168-69.

⁶¹ Wilintz, *The Age of Reagan*, 170.

factors fed the recovery. Oil prices fell by a third between 1981 and 1983.⁶² Congruently, Reagan increased spending on military armaments. This “military Keynesianism” increased aggregate demand, resulting in about “4% [growth] per year from the recession year of 1982 through the cyclical peak in 1990.”⁶³ Most importantly, the Federal Reserve chairman, Paul Volcker, slashed interest rates, creating a rapid expansion of business activity. These factors had little to do with Reagan’s specific tax policies. In fact, if the electorate had elected Miss Piggy, the 1980s would be remembered as the “Piggy Miracle.” But perception is the key to politics as the “Reagan Recovery” came to define the era.⁶⁴

Despite apparent economic recovery, presidential hopeful Walter Mondale promoted many New Democrats’ NIP ideas. These ideas were needed, Mondale claimed, because Reagan’s economic policies were “destroying industry—not building it.”⁶⁵ Although he remained “a profound believer in the free enterprise system,” Mondale argued that “government must work in partnership with the market” in order to direct federal aid to “those communities and regions hit hardest by economic change” to counter deindustrialization.⁶⁶ Furthermore, the

⁶² Economist James Galbraith provided perhaps the best summary for how a problem that haunted the 1970s was finally resolved in the 1980s. In 1979, Volcker recognized that the U.S. interest rate was effectively the world interest rate and thus could be used as “a weapon against the price of the strategic commodity that America no longer controlled, which was oil.” his was possible because throughout the 1970s, “as oil prices rose, much of the world had gone into debt, mainly to the commercial banking system of the United States. Thus, most of the world . . . was vulnerable to the interest rate weapon.” The higher interest rates drove the value of the dollar up by 60 percent, plunging the “indebted countries of the developing world into a twenty-two-year depression” effectively removing them from competition for oil. By the mid-1980s, oil “was flowing cheaply to the Global North once again.” See James K. Galbraith, *The End of Normal: The Great Crisis and the Future of Growth* (Simon & Schuster, 2014), 53-54.

⁶³ David Kotz, *The Rise and Fall of Neoliberal Capitalism* (Harvard University Press, 2015), 226 FN 15.

⁶⁴ Wilentz, 170-71; Galbraith, *End of Normal*, 53-56; Kotz, *The Rise and Fall of Neoliberal Capitalism*, 75-76.

⁶⁵ Walter F. Mondale, address to the Twenty-First Constitutional Convention of the United Steel Workers of America, September 11, 1982, 5; U.S. Congress, Senate Committee on Banking, Finance and Urban Affairs, *Industrial Policy: Hearings Before the Subcommittee of Economic Stabilization of the Committee on Banking, Finance and Urban Affairs, McKinzie Report*, 98th Cong., 1st sess., Part 5 November 14, 1983, 635 [hereinafter *McKinzie Report*].

⁶⁶ Walter F. Mondale, excerpts from a speech to the Industrial Union Department Legislative Conference, May 4, 1983, 4; *McKenzie Report*, 635.

1984 Democratic Party Platform echoed the New Democrats' emphasis on sunrise industries by pledging "a series of long-term investments in research, infrastructure, and above all in people. Education, training, and retraining will become a central focus in an economy built on change."⁶⁷

The 1984 presidential election was a disaster for the Democratic Party. Voters soundly rejected Mondale, as Reagan won 59 percent of the popular vote and every state except Mondale's home of Minnesota.⁶⁸ Reagan's win marked an era of new answers. In order to stay competitive on the national level, Democrats had to adjust to the new paradigm of free market rhetoric that Reagan effectively used. New Industrial Policy and other measures that called for direct government oversight in investment were scrapped. "Full Employment," a staple ideal since the 1940s, fully vanished from the party's platform. What remained was the New Democrats' goal of using the "tax code as one of the major mechanisms through which Government could shape the economy and private decisions."⁶⁹

In an unforeseen turn of events, the newly reelected president gave the Democrats a political opening to introduce their tax agenda. As stated previously, Bradley and Gephardt submitted their tax plan to the CBO for review in 1983. Reagan interpreted this

⁶⁷ Political Party Platforms, "1984 Party Platform," July 16, 1984, University of California Santa Barbara American Presidency Project, <https://www.presidency.ucsb.edu/documents/1984-democratic-party-platform>. Key passages include:

"Instead of government by neglect, a Democratic Administration will establish a framework that will support growth and productivity and assure opportunity."

"In place of conflict, a Democratic Administration will pursue cooperation, backed by trade, tax and financial regulations that will serve the long-term growth of the American economy and the broad national interest."

"Instead of ignoring America's future, a Democratic Administration will make a series of long-term investments in research, infrastructure, and above all in people. Education, training and retraining will become a central focus in an economy built on change."

⁶⁸ "How Groups Voted in 1984," *Roper Center for Public Opinion Research at Cornell University*, <https://ropercenter.cornell.edu/polls/us-elections/how-groups-voted/how-groups-voted-1984/>. Mondale won Minnesota by only 4,000 votes.

⁶⁹ E.J. Donnie, Jr., "Washington Talk: Political Memo-For Richer, for Poorer, In Taxes and Ideology," *New York Times*, August 22, 1986.

as a move by the Mondale campaign to make tax reform a primary talking point.⁷⁰ To counter, Reagan announced “a plan of action to simplify the entire tax code, so all taxpayers, big and small, are treated more fairly.”⁷¹

After winning in 1984, Reagan continued to focus on taxation. However, the president gave no guidance to Secretary of the Treasury, Don Regan, on how to accomplish tax reform. Reagan’s actions surrounding the call for a new tax bill without direction, specifics, or any general guidance illustrates how “coming after the president’s stunning victory in 1984, the Reagan revolution seemed divided and oddly adrift during his second term.”⁷² More specifically, Stuart Spencer, a political consultant for Reagan’s 1984 campaign, stated that “the Reagan Administration fired all its bullets very early and very successfully in the first two years The most striking thing I discovered is that they don’t have a goddam thing in the pipeline. They don’t have an idea.”⁷³

With no direction from the president, Bradley’s proposal for lower tax rates, closing loopholes and tax shelters, and a revenue neutral mandate became the basis for the Treasury Departments proposals.⁷⁴ On November 26, 1985, Secretary Regan

⁷⁰ Birnbaum and Murray, *Showdown at Gucci Gulch*, 58.

⁷¹ Ronald Reagan, “Address Before a Joint Session of the Congress on the State of the Union,” (speech, Washington, DC, January 25, 1984), University of California Santa Barbara American Presidency Project, <http://www.presidency.ucsb.edu/ws/?pid=40205>; David Rosenbaum, “The Tax Reform Act of 1986: How the Measure Came Together; A Tax Bill for the Textbooks,” *New York Times*, October 22, 1986. Many Democrats in attendance viewed Reagan’s words as pure political semantics and audibly laughed as the president promised study and dramatically reform his own tax policies.

⁷² Jane Mayer and Doyle McManus, “How the Reagan Myth Was Made,” *The Washington Post*, September 18, 1988, C 1-2.

⁷³ Mayer and Doyle McManus, “How the Reagan Myth Was Made,” C 1-2.

David Stockman, former head of Reagan’s Office of Budget Management piled on to this narrative in his own tell-all book: “After November 1981, the administration locked the door on its own disastrous fiscal policy jail cell and threw away the key. The President would not let go of his tax cut. Cap Weinberger [Secretary of Defense] hung on for dear life to the \$1.46 trillion defense budget” while other important advisors “ceaselessly endeavored to keep all the bad news out of the Oval Office and off the tube. The nation’s huge fiscal imbalance was never addressed or corrected; it just festered and grew.” David Stockman, *The Triumph of Politics: How the Reagan Revolution Failed* (Harper & Row, 1986), 13.

⁷⁴ US Department of the Treasury, *Tax Reform for Simplicity, Fairness, and Economic Growth*, 3 vols (US Department of the Treasury, 1984); Birnbaum and Murray, *Showdown at Gucci Gulch*, 42-64.

presented his initial plan to the president in a closed meeting. Regan's embrace of Bradley's proposals shocked the president's advisors. The proposed corporate tax increase was a "complete denunciation of the president's policies in 1981." William Niskanen, a key presidential aid, broke the awkward silence that followed the proposal's presentation with: "Walter Mondale would have been proud." But Reagan, whose "eyes grew hazy" throughout the meeting "didn't seem to grasp the significance of the proposal."⁷⁵ Instead, he fixated on the proposed high-rate tax cut from 50-28 percent, and only opposed the plan's elimination of tax deduction for country-club dues.⁷⁶

In December of 1985, the bill worked its way through committee and was introduced to the House floor for a vote. The version adhered to President Reagan's commitment to lower the top rate. However, it also included a plan written by two Harvard professors, Dale W. Jorgenson and Alan J. Auerbach, that ended the Accelerated Cost Recovery System (ACRS) enacted in the 1981 tax reform bill.⁷⁷ This was no small accomplishment. In fact, it represents a fundamental moment of how New Democrats enacted reform through Reagan's second term.

As noted earlier, the ACRS was promoted as a strategy to induce new investment into heavy manufacturing by dramatically reducing the depreciation rate for new construction. This begs the question of what, exactly, is depreciation in industrial manufacturing? Take, for example, a steel mill. The mill itself is a capital asset, it has a value that is taxed. However, normal wear and the fact that the mill uses increasingly outdated technology make it worth less over time. Its value depreciates. The postwar tax code recognized this and lowered taxes accordingly, usually on a fixed forty-year model.

⁷⁵ Birnbaum and Murray, *Showdown at Gucci Gulch*, 63.

⁷⁶ Birnbaum and Murray, *Showdown at Gucci Gulch*, 62-63.

⁷⁷ Rothenberg, *The Neo-Liberals*, 179-80.

This was done to create increased tax savings that would be used to reinvest back into the mill with updated equipment to maintain market competitiveness and to continue to employ Americans. This dynamic is central to the postwar ROI model that factored long-term stable growth into conceptions of profitability. The government facilitated this paradigm through the tax code to ensure continued feasibility of the Fordist political economy.⁷⁸

However, crises of the 1970s—oil cost, inflation, global competition—increasingly made reinvestment in manufacturing unappealing. Profit could be made by simply using assets on hand to merge with other companies. This, of course, is Reich’s “paper entrepreneurialism” that correctly described the first stages of financialization. In order to reverse this trend, the ACRS created a short depreciation schedule (5-10 years for most industrial investments, 15 years shorter than previous tax laws allowed), which allowed corporations to write off investments in order to receive massive tax subsidies. These tax savings would be incorporated into the “black ink” side of the balance books to be used as further collateral for loans. Finally, the ACRS “accelerated” the deduction schedule by allowing companies to receive tax benefits within the first two years of owning an asset. The end goal, like the 1964 Tax Cut, was to use the tax code to incentivize corporations to immediately reinvest back into building new manufacturing centers, and thus employ industrial laborers.⁷⁹

The ACRS did not work as intended. Instead of massive reinvestment in American heavy industry, the ACRS fueled speculation in get-rich quick schemes. As we

⁷⁸ Steuerle, *Tax Decade*, 46-48; Levy, “Accounting for Profit.”

⁷⁹ Lawrence Lindsey, “Taxpayer Behavior and the Distribution of the 1982 Tax Cut,” National Bureau of Economic Research, Oct. 1985; Fullerton and Henderson, “Long-Run Effects of the Accelerated Cost Recovery System,” 363-72; Prasad “The Popular Origins of Neoliberalism in the Reagan Tax Cut of 1981,” 368, 372; Eugene Steuerle, *Tax Decade*, 39-45.

will examine in detail in the next chapter, windmill farms appeared across the southwest that generated power “at far greater cost than other utilities.”⁸⁰ New office buildings—known as “see through” because they remained unrented and empty for years—were constructed.⁸¹

These structures were profitable because the ACRS effectively produced a negative tax rate for investors. When a firm, such as GE Financial, invested \$1 million in the construction of a new office building, the accelerated deduction was received in the first few years of owning the asset (e.g., an empty office building). This deduction would be used to offset taxation, sometimes at a negative rate. Thus, firms would make money by borrowing and building unnecessary infrastructure because they would save millions or billions of dollars in taxation. In summary, the ACRS incentivized investing in cheaper “unproductive” sectors of the economy and unused buildings, while effectively creating financial profits for many corporations.⁸²

It is important to take a moment to fully understand the dynamics surrounding the failure of the ACRS. The goal was to induce investment back into heavy manufacturing with tax cuts. However, in practice, this strategy could not escape the transition from ROI to ROE. Tax savings were not reinvested back into long-term capital production, but rather short-term returns on speculative investments. In fact, the dynamic created by the ACRS can be taken one step further: the policy itself transformed many capital assets that

⁸⁰ Fullerton and Henderson, “Long-Run Effects of the Accelerated Cost Recovery System,” 368-72; Steuerle, *Tax Decade*, 49.

⁸¹ Kitty Calavita, Henry N. Pontell, and Robert H. Tillman, *Big Money Crime: Fraud and Politics in the Savings and Loan Crisis* (University of California Press, 1997); Martin Mayer, *The Greatest-Ever Bank Robbery: The Collapse of the Savings and Loan Industry* (Charles Scribner’s Sons, 1990).

⁸² The ACRS is only one of many tax loopholes in the 1981 tax bill. Another, Safe-Harbor-Leasing, allowed one company to sell their tax savings to another. For example, Ford Motor Company sold IBM the tax breaks on their entire \$1 billion 1981 investment program, for a price between \$100 million and \$200 million. When combined with the ACRS, companies could profit from their tax avoidance. Robert McIntyre, *Money for Nothing: The Failure of Corporate Tax Incentives 1981-1984* (Citizens for Tax Justice, 1986); Steuerle, *Tax Decade*, 45-51.

had been classically the vehicles of long-term investment *into* short-term equity-based assets. By rewarding investment—even if highly leveraged—up front, the ACRS made the definitive model of long-term investment, buildings, into short-term, highly liquid, assets. What followed the implementation of the ACRS was not a new morning of heavy manufacturing and a growing number of industrial jobs. Instead, domestic investment in new plant and equipment dropped by nearly \$100 billion a year beginning in 1981.⁸³ And, as we will see in the next chapter, the ACRS became a central mechanism that led to highly speculative real estate misadventures, resulting in the Savings and Loan Crises of the mid-1980s.⁸⁴

The authors of TRA86 held the ACRS as the central tax loophole that needed to be reformed. Investment in speculative schemes under the guise of reinvigorating the dying industrial economy was, in their minds, a waste of taxpayer money. Furthermore, these schemes did not create new jobs—specifically jobs in the new sunrise industries that Democrats asserted would provide for future job growth. Despite the failure of the ACRS, ending the policy was rigorously contested by some in the Republican supply-side coalition that viewed corporate tax cuts as an essential for economic growth.

Representative Newt Gingrich was one of the first to speak against the new tax reform bill. According to Gingrich, ending the ACRS “virtually guarantees the collapse of heavy industry in America If you are in a steel plant in Pennsylvania . . . an automobile plant in Michigan . . . building a farm in Iowa. . . . you are going to be

⁸³ In 1982, after just one year of ACRS, investment dropped from \$175 billion to \$165 billion. Francis X. Clines, “Corporate Tax Upsets Reagan,” *New York Times* January 27, 1983, Section D, page 1, <https://www.nytimes.com/1983/01/27/business/corporate-tax-upsets-reagan.html>.

⁸⁴ William K. Black, *Best Way to Rob a Bank Is to Own One: How Corporate Executives and Politicians Looted the S&L Industry* (University of Chicago Press, 2013).

unemployed.”⁸⁵ In his most enlightening statement, Gingrich defined exactly how the elimination of the ACRS will destroy American industry:

[TRA86] raises the cost of capital, because it makes it less desirable to invest . . . the cost of investing will have gone up. . . . What is the result of this? . . . civilian unemployment will be up . . . 1,500,000 more Americans will be out of work in 1991.⁸⁶

In short, the Americans will lose their jobs when their employer no longer receives tax subsidies to stimulate investment in modernizing heavy industry.⁸⁷

Gingrich did not address the warped incentives that the ACRS created. This strategy served a distinct political goal. By only referencing industrial investment, Gingrich attempted to connect the Democratic plan with deindustrialization. Any attempt to reform corporate tax breaks would increase unemployment. This is an explicitly backwards-looking vision that ignored the economic shifts of the 1970s and early 1980s that led to both the off-shoring of American industrial jobs and the growth of finance as a main source of corporate revenues.

Representative Byron Dorgan directly challenged Gingrich’s claims. Dorgan—a liberal democrat who would later vote against the repeal of the Glass-Steagall Act and warned about unregulated financial derivative speculation—initiated a full-throttled attack on the ACRS.⁸⁸ According to Dorgan, the ACRS and the 1981 tax bill were “bankrupt, terrible unfair, and desperately in need of change.” The ACRS was

⁸⁵ “Shortages of Rostenkowski Tax Package,” Rep. Gingrich, speaking on H. 10807, 131 Cong. Rec., 2nd sess., *Congressional Record* (December 4, 1985).

⁸⁶ Rep. Gingrich, H. 10808, 99th Cong., 1st sess., *Congressional Record* 131 (December 4, 1985).

⁸⁷ Rep. Gingrich, H. 10807-08, 99th Cong., 1st sess., *Congressional Record* 131 (December 4, 1985).

⁸⁸ Stephen Labaton, “Congress Passes Wide-Ranging Bill Easing Bank Laws,” *New York Times*, November 5, 1999.

“embarrassingly generous” allowing corporations to “write things off so much more rapidly than their economic depreciation would justify.” In combination with the investment tax credit, the United States had “many corporations that earn billions of dollars and pay zero in taxes.” The “point of all this” was to correct these two disastrous policies while providing “tax relief for millions of Americans.”⁸⁹

Dorgan’s argument centered on how ERTA81 unfairly benefited corporations over working Americans. First, Dorgan explained that the ACRS provided cheap credit for large capital investment. However, there is no stipulation that those investments be in the United States. Thus, “part of the absurdity of the current law is that we encourage investors in the United States to build factories elsewhere.” Manufacturers, from automakers to home electronics, were using government subsidized investment to build factories in low-wage countries, resulting in a perverse outcome where “American taxpayers [were] subsidizing American job loss.” This simple fact cut through much of Gingrich’s argument by showing that in practice the ACRS had no connection to the well-being of American workers; instead, it helped subsidize job loss and increasing inequality.⁹⁰

Furthermore, instead of reinvesting in industrial manufacturing, many companies used their tax savings to simply buy other, more profitable, firms. As explained by Dorgan: “[the] 1981 tax bill [was] so generous to capital-intensive industry, a railroad that amassed enormous amounts, a couple of hundred billion in tax benefits . . . took

⁸⁹ Rep. Dorgan speaking on H. 10808-09, 99th Cong., 1st sess., *Congressional Record* 131 (December 4, 1985); Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986), Sec. 201.

⁹⁰ Rep. Dorgan speaking on H 10809, 99th Cong., 1st sess., *Congressional Record* 131 (December 4, 1985). For an in-depth analysis of how corporations constantly chased ever-lower labor costs, see Jefferson Cowie, *Capital Moves: RCA’s Seventy-Year Quest for Cheap Labor* (The New Press, 1999).

those tax benefits and went right out and bought a gas company.”⁹¹ Dorgan’s example directly referenced a strategy made famous by U.S. Steel. In 1979, the corporation closed twelve steel mills and canceled plans to invest in upgrading a steelwork plant. Then in 1981, U.S. Steel used the savings created by the mill closures to finance the purchase of Marathon Oil—a move that increased profits without expanding labor opportunities in the economically ravaged Rustbelt. The ACRS was designed to counter this exact scenario. Instead, the tax policy effectively subsidized the practice. Now, U.S. Steel could simply finance the construction of a few unneeded windmill farms and use the benefits of the ACRS to purchase Marathon Oil. The ACRS did nothing to prevent concentrating corporate wealth, nor aid in the creation of American industrial jobs.⁹²

Dorgan recognized that under the ACRS, economic growth in a financialized economy was unfair. Corporate use of the ACRS generated increased revenues and stock prices for firms without any benefit to labor. While the “Reagan Recovery” seemed to create opportunity for all Americans, Dorgan argued that most of the gains were captured by the wealthiest at the cost of the average worker. The Democratic plan to end the ACRS sought to eliminate a key factor that led to an increasingly unequal economic system.

The focus on the ACRS created a clear agenda where the Democrats showed the public that they had come to embrace “free market” strategy. The ACRS was cast as a Republican policy that unfairly used government action to distort tax incentives and give corporations a subsidized means to profit on unproductive speculation. Democrats were able to clearly and concisely show that Republican policies used the government to create

⁹¹ Rep. Dorgan, Dorgan speaking on H. 10812, 99th Cong., 1st sess., *Congressional Record* 131 (December 4, 1985).

⁹² Neil Fligstein, *The Transformation of Corporate Control* (Harvard University Press, 1990), chapters 7-8.

winners and losers.⁹³ According to Jeffrey Birnbaum and Alan Murray, two *Wall Street Journal* reporters, TRA86 “called the bluff of Republicans who spouted similar free-market rhetoric, while jealously guarding tax breaks that tilted the playing field toward their friends and constituents.”⁹⁴ The policies of tax reform created a means for Democrats to take ownership of free market rhetoric by actually implementing principles that did not simply bolster speculation and manipulation.

Overt governmental management of the marketplace had been thoroughly rejected by voters in 1984. However, Democrats still supported using government to focus on fostering new industries to provide new generations of Americans with economic growth and opportunity.⁹⁵ By eliminating the ACRS, Democrats hoped to encourage merit-based investment. Instead of creating artificial incentives—loopholes and tax shelters—to invest in dying industries, they believed that TRA86’s market-based incentives would finance newer, economically expanding industries—research and technology. Here again Bradley and other New Democrats’ faith in market dynamics was on full display. “In between the investor and the investment comes the tax code,” Bradley argued as early as 1982. Tax policy “diverts rates of return and skews investment not to what has real value in the marketplace, but to where Congress thinks it should go.” If “you clean it up,” the tax code would “let a person decide what he or she is going to invest in, based on what the real value is in the marketplace.”⁹⁶

⁹³ Rothenberg, *The Neo-Liberals*, 180.

⁹⁴ Birnbaum and Murray, *Showdown at Gucci Gulch*, 28.

⁹⁵ Richard Reeves, “The Ideological Election,” *New York Times*, February 19, 1984; Lawrence Lindsey, *The Growth Experiment: How the New Tax Policy is Transforming the U.S. Economy* (Basic Books, 1990); Bluestone and Harrison, *The Deindustrialization of America*, “Reindustrialization with a Human Face,” 245-55; Barry Bluestone, *Foreword*, vii-xvi in *Beyond the Ruins: The Meanings of Deindustrialization*, ed., Jefferson Cowie and Joseph Heathcott (Cornell University Press, 2003).

⁹⁶ Statement on Tax Policy by Senator Bill Bradley to the Washington Press Club, May 27, 1982.

The incentives within ACRS focused on reviving industrial manufacturing. In fact, the program did not allow for real economic depreciation for computers.⁹⁷ Again, this distinctly backward vision of America did not recognize the personal computer, robotics, telecommunications, medical and other types of high-end research were the new key sectors in the changing economy.⁹⁸ According to one political analyst, removing artificial incentives created by the ACRS would allow investment “by nature [to] flow into the most productive areas.”⁹⁹ Once removed, America could finally embrace the New Economy. Eugene Steuerle, a noted economist who worked with Reagan’s Treasury Department in creating the TRA86, stated that TRA86 recognized “a downsizing of the idealized invention from the large machine with cogs, wheels, nuts, and bolts to the mini-machine whose principle components were tiny microchips; and, more generally, a continuing movement from an industrial age to a technological age to an age of information.”¹⁰⁰ The future, for both investors and labor, lay not in heavy industry, but in the technological revolution of the microprocessor and advanced research.¹⁰¹

The policies implemented by TRA86 reflect a fundamental shift in strategy by the Democratic Party to create a new political economic philosophy that embraced the postindustrial and financialized economy centered on fairness and growth. This new Democratic strategy was not simply acquiescence to Republican supply-side ideology.

⁹⁷ Steuerle, *Tax Decade*, 47.

⁹⁸ *Winning Technologies: A New Industrial Strategy for California and the Nation*, report by the California Commission on Industrial Innovation, September 2, 1982; Charles Alexander, “The New Economy,” *Time*, May 30, 1983; Fox Butterfield, “Two Areas Show Way to Success in High Technology Industry,” *New York Times*, August 7, 1982. For an analysis of the ACRS failures to support computers and other forms of new technology, see Steuerle, *Tax Decade*, 46-48.

⁹⁹ Rothenberg, *The Neo-Liberals*, 180.

¹⁰⁰ Steuerle, *Tax Decade*, 189.

¹⁰¹ Bluestone and Bennett Harrison, *The Deindustrialization of America*, “Developing the ‘Sunrise’ Industries,” 245-47; Bluestone, *Foreword*, vii-xvi in *Beyond the Ruins*.

The tax bill attempted to fix deficiencies ignored by the 1981 Republican plan as tax rates were lowered, or eliminated, for the middle class and the poor, finally solving the problem of 1970s inflationary bracket creep. Growing inequality caused by financialization was thought to have been addressed as loopholes and tax shelters that overwhelmingly benefited corporations and promoted speculative investment in unproductive economic sectors were eliminated. Deindustrialization was accepted as policy shifted to create investment in new industries that were understood to offer opportunity and economic growth to the next generation of American voters.

The media lauded the passage of TRA86 as a bipartisan success. Most coverage focused on how the bill brought fairness back to the tax code rather than on the cuts to the top marginal income rate. Corporate loopholes, low tax rates, and a general recognition of growing inequality between individual tax payers and corporations had become quotidian talking points for the media by 1986. This fixation was due in part to an influential report released two years prior. In 1984, a public-interest lawyer named Robert McIntyre showed that 128 out of 250 large and profitable companies paid no federal income taxes.¹⁰² After the release of the report, the public did not think that the plight of “normal Americans” would be heard above the influence of corporate lobbyists.¹⁰³

Newspapers praised the bill’s success in curbing corporate influence in fiscal policies. According to an interview with Fred Wertheimer, a “long-time advocate of tax revision” and the “president of a public affairs lobby,” TRA86 “simply accomplishes what nobody believed was possible” by taking “a huge chunk out of special interest after

¹⁰² These companies included GE, Boeing, Dow Chemical, and Lockheed.

¹⁰³ Wayne Biddle, “5 Big Military Builders Paid No Taxes for 3 Years,” *New York Times*, October 16, 1984; William Greider, “Earn a Billion! Pay No Taxes! The Biggest Scandal in Washington is the Corporate Tax Code Congress Enacted,” *Rolling Stone*, April 25, 1985; Robert McIntyre, *Money for Nothing*; Birnbaum and Murray, *Showdown at Gucci Gulch*, 11-13.

special interest who were not paying their fair share.” The Democrat led bill achieved this fairness “over the loud protests of lobbyists.” In the same article, James Galbraith, “an economist at the Lyndon B. Johnson School of Public Affairs at the University of Texas who is associated with the Democratic Party's left wing” stated that ““any bill that shifts the tax burden of more than \$100 billion from individuals to corporations, drops six million poor people from the tax rolls, rids the tax code of scores of loopholes and taxes capital gains at the same rate as earned income”” was a progressive success story.¹⁰⁴

This narrative continued into 1987 when two *Wall Street Journal* reporters, Jeffrey Birnbaum and Alan Murray published *Showdown at Gucci Gulch*, a “behind-the-scenes” account of TRA86. This deeply-researched narrative describes the Tax Reform Act of 1986 as the “single most sweeping change in America’s income tax.” Central to this transformation is a triumphalist story of how American politicians enacted fiscal policy that would lose the clients of Gucci-clad corporate lobbyists “billions of dollars” to “bring fairness to the tax system” with one of the largest corporate tax increases in history.¹⁰⁵

Although the tax bill was described as bipartisan, media coverage did not hesitate to name Bill Bradley the “The Real Hero of Tax Reform.”¹⁰⁶ A glowing *Washington Post* article described Bradley as the “man who launched the great tax-reform crusade of 1986.” The article pressed this point, stating that even “many Republicans concede that it was Bradley who provided the intellectual spark.” Bradley’s philosophy behind “Fair Tax

¹⁰⁴ E.J. Donnie, Jr., “Washington Talk: Political Memo-For Richer, for Poorer, In Taxes and Ideology,” *New York Times*, August 22, 1986.

¹⁰⁵ Birnbaum and Murray, *Showdown at Gucci Gulch*, 3-22, 253-83.

¹⁰⁶ David Ignatius, “The Real Hero of Tax Reform,” *The Washington Post*, May 18, 1986, <https://www.washingtonpost.com/archive/opinions/1986/05/18/the-real-hero-of-tax-reform/4ce6b8dc-226e-4eed-b853-b3a5c21dde10/>.

Plan” was described as a breakthrough for Democrats as the plan was “an example of what Democrats have been looking for—mostly without success—for much of the last decade. It synthesized liberal and conservative ideas in a new package that could appeal to middle-class Americans. . . . And who, it might be added, increasingly have been voting Republican in recent presidential elections.” Most importantly, Bradley’s proposal “offered Democrats a way to shed their anti-growth, tax-and-spend image” and allowed them ‘to advocate economic growth and fairness simultaneously.’” The *New York Times* recognized that Bradley had “led his party to accept the idea of marrying equity and productivity.”¹⁰⁷ Birnbaum and Murray reaffirmed Bradley’s role a year later as again and again Bradley was described as “pivotal figure” who tirelessly led the tax reform to implement “fairness and opportunity” into the maligned tax code.¹⁰⁸

The media’s favorable portrayal of Bradley, and the passage of TRA86, gave the Democrats momentum heading into the 1986 mid-terms. Democrats now had a strong critique on both Reagan’s leadership, and emphasized their new ideas on how to remake the economy. This tactic was successful. Democrats gained five more seats in the House, and more impressively, eight Senate seats by defeating many Republican “freshman incumbents who were first elected on Reagan’s coattails in 1981.”¹⁰⁹

Democratic control of both the House and Senate effectively limited Reagan’s legislative agenda in 1987. Democrats used their majority to defeat Reagan’s controversial Supreme Court pick, Robert Bork. Unable to further advance his agenda,

¹⁰⁷ Ignatius, “The Real Hero of Tax Reform”; Donnie, Jr., “Washington Talk: Political Memo- For Richer, for Poorer, In Taxes and Ideology,” *New York Times*, August 22, 1986.

¹⁰⁸ Birnbaum and Murray, *Showdown at Gucci Gulch*, 5-6, 23-31, 257-58, 277-79, 282.

¹⁰⁹ Gil Troy, *The Reagan Revolution: A Very Short Introduction* (Oxford University Press, 2009), 79; “How Groups Voted in 1984,” *Roper Center for Public Opinion Research at Cornell University*, <https://ropercenter.cornell.edu/polls/us-elections/how-groups-voted/how-groups-voted-1984/>.

Reagan was forced into a defensive political position as Iran Contra, the Savings & Loan scandals, and 1987 Wall Street market crash left his administration mired in crisis. For the first time in a decade, Democrats were seen as the political party with a positive economic strategy. Conversely, Reagan's approval ratings fell from 67 percent in June, 1986 (when TRA86 was passed), to an average of 48 percent throughout 1987. Democratic momentum, Reagan's falling approval rating, and growing Republican disarray set the scene for the 1988 presidential election.¹¹⁰

All eyes turned to Bradley as the presidential election neared in the summer of 1987. In two "extraordinary editorial appeal[s]," Bradley was depicted as "the central figure in 'a new core for the Democratic party.'"¹¹¹ "Michael Kinsley, editor of the *New Republic*, followed with a nationally syndicated column in which he asserted: 'Now is the Democrats' best opportunity in years . . . and Bill Bradley is the Democrats' best hope.'"¹¹² Bradley's role as a leader in the development and passage of TRA86 led Dan Rostenkowski, "the powerful chairman of the House Ways and Means Committee" to call him "my candidate for President." "Even New Right political consultant Roger Stone, who in the past has called Bradley 'slow on his feet, a lightweight,'" conceded: "I have never misjudged anybody the way I misjudged Bill Bradley."¹¹³

The push for Bradley to run for president was based on more than his ability to shape legislation. Bradley's Fair Tax came to represent "a postwar generation unconstrained by geography or economics, a mobile generation, able to choose its own

¹¹⁰ "Presidential Approval Rating, Month, 1981-1986," University of California Santa Barbara American Presidency Project, <http://www.presidency.ucsb.edu/data/popularity.php?pres=40>.

¹¹¹ Clifford D. May, "Learning to Govern the Bill Bradley Way," *New York Times*, March 1, 1988.

¹¹² Randall Rothenberg, "Why Bradley isn't Running," *New York Times*, August 2, 1987, section 6, page 29.

¹¹³ Randall Rothenberg, "Why Bradley isn't Running," 29.

destiny.”¹¹⁴ Democrats seemed to see in Bradley a counter to Reagan: a successful public figure that represented “classic American culture,” but used Democratic principles to appeal to his generations shifting political and economic values.¹¹⁵ Bradley, however, did not run for president in 1988. Despite that “the desire, even desperation, for a Bradley Presidential bid [was] almost palpable in Washington” from both Democrats and political pundits, Bradley insisted that “the time is not right for me.”¹¹⁶ Reasoning for Bradley’s decision not to run ranged from a suspicion that he wanted to further groom his campaign experience in order to improve his “uninspiring” oratorical style to a genuine concern for local New Jersey politics.¹¹⁷

Although Bradley did not run, the ideas behind TRA86 led to the creation of a new political economy for the Democratic Party. After 1986, New Democrats expanded upon their philosophy that “high technology [was] a source of jobs and economic growth”¹¹⁸ and that “investment [in] high technology [was] the contemporary answer to the New Deal.”¹¹⁹ Senators such as Al Gore, Charles Schumer, Paul Tsongas, and Tim Worth successfully ran on this mantle, eventually combining technology with environmentalism to create the pillars of the modern Democratic Party.¹²⁰

The 1988 Democratic presidential nominee, Michael Dukakis, ran a campaign embracing this new mantle. Specifically, Dukakis’s term as governor of Massachusetts oversaw the beginnings of successful transition of an eroding manufacturing base to a

¹¹⁴ Randall Rothenberg, “Why Bradley isn’t Running,” 30.

¹¹⁵ Randall Rothenberg, “Why Bradley isn’t Running,” 30.

¹¹⁶ Randall Rothenberg, “Why Bradley isn’t Running,” 30.

¹¹⁷ Rothenberg, “Why Bradley isn’t Running,” 29; Clifford D. May, “Learning to Govern the Bill Bradley Way,” *New York Times*, March 1, 1988; AP Wire Service, “When Bradley is ready...,” January 24, 1988.

¹¹⁸ Robert Pear, “The 1992 Campaign: Record in Congress; In House and Senate, Tsongas Went His Own Way,” *New York Times*, February 25, 1992, Section A, Page 17.

¹¹⁹ “New Faces in the Senate: Atari Democrat,” *Time*, Nov 17, 1986.

¹²⁰ E.J. Donne, “Washington Talk; Greening of Democrats: An 80's Mix of Idealism and Shrewd Politics,” *New York Times*, June 14, 1989; Lily Geismer, *Don't Blame Us*.

booming high-tech and research industries economy. “By 1985, Massachusetts had the highest percentage of service-sector workers and the highest average per capita income of any state in the country.”¹²¹ Labeled the “Massachusetts Miracle” by supporters, Dukakis’s economic success and image of an “unpretentious man who rode the subway every workday” seemed ready-made to combat a Republican nominee born to wealth.¹²²

For the first time in over ten years, the Democratic candidate had a strong economic strategy. Fairness and growth came together in Dukakis’s image of an everyday working man who presided over a high-tech boom. This new image forced the Republican nominee, George H.W. Bush, to declare during his nomination to “read my lips: no new taxes.” However, the “needle-mover” in 1988 was not economics. In their opposition research, a Political Action Committee discovered a program in Massachusetts—initiated by Dukakis’s Republican predecessor—that allowed “brief furloughs to state prison inmates.” Dukakis did not discontinue the program until after the 1988 primaries began. Willie Horton, a man convicted of first-degree murder, had “raped a white woman in Maryland, assaulted her husband, and stolen their car” while on furlough. Lee Atwater, Bush’s campaign head, made sure that a “photograph of Horton, a black man with a menacing look,” was plastered across the media. Dukakis failed to adequately counterattack and his campaign became symbolized by “soft liberal values.” “Law and order,” once again, made the Republican campaign.¹²³

¹²¹ Lily Geismer, “Atari Democrats,” *Jacobin*, February 8, 2016, <https://www.jacobinmag.com/2016/02/geismer-democratic-party-atari-tech-silicon-valley-mondale>.

¹²² Allan R. Gold, “Fiscal Experts Give Dukakis More Credit than Bush Does,” *New York Times*, September 30, 1988, Section A, page 1; Steve Lohr, “Bush, They Say, Is Indeed a Connecticut Yankee from King Henry’s Court,” *New York Times*, July 5, 1988, Section B, page 6; David Rosenbaum, “Bush Easily a Millionaire, But the Growth was Slow,” *New York Times*, June 6, 1988, Section A, page 1; Wilentz, *The Age of Reagan*, 264-67. For a detailed analysis of Dukakis as governor and presidential candidate, see Lily Geismer, *Don’t Blame Us*, 251-279.

¹²³ Geismer, *Don’t Blame Us*, 277-79; Wilentz, *The Age of Reagan*, 270-72; Joan Didion, “Insider Baseball,” *New York Review of Books*, October 27, 1988, reprinted in Joan Didion, *Political Fictions* (Vintage International, 2001),

Bush won the popular vote by 54 percent to 46 percent, and secured an overwhelming Electoral College total with 426 votes to 112. This crushing victory obscured all memory of the economic salience of Dukakis, and more generally, the Democratic Party after 1986. Instead, the Reagan Revolution reified into undeniable fact as the Republican Party won a third successful presidential election for the first time since 1928.

Bill Clinton would, of course, become the standard-bearer of the New Democratic Party. Clinton's presidency, however, owes a great deal to the New Democrats of the early 1980s. Economic growth was fueled by the massive investment in Silicon Valley, the Research Triangle, Route 128, and the rise of internet-based business. Clinton successfully echoed the 1986 focus on "fairness" and moved to raise the top marginal tax rate.¹²⁴ Policies that embraced the politically successful free market ethos of growth and opportunity, not redistribution—welfare reform, a focus on retraining industrial workers, and a full embrace of the "New Economy"—shaped the Clinton presidency.¹²⁵ Even Clinton's famous mantra of "It's the economy, stupid" echoes Bradley's and other early 1980s New Democrats' focus on economic opportunity. Continuing the fixation on

19-59. "Law and Order" has had a deep political salience since the Johnson administration's initiation of the Office of Law Enforcement Assistance and the 1968 Nixon campaign. The political usage of the term, and its role in forming an image of mass criminality, is central to the works of the history of the American Carceral State. *See for example*, Khalil Gibran Muhammad, *The Condemnation of Blackness: Race, Crime and the Making of Urban Modern America* (Harvard University Press, 2011); Elizabeth Hinton, *From the War on Poverty to the War on Crime: The Making of Mass Incarceration in America* (Harvard University Press, 2017); Ruth Wilson Gilmore, *Golden Gulag: Prisons, Surplus, Crisis, and Opposition in Globalizing California* (University of California Press, 2007).

¹²⁴ William J. Clinton, "Address Before a Joint Session of the Congress on Administration Goals," (speech, Washington, DC, February 17, 1993), University of California Santa Barbara American Presidency Project, <http://www.presidency.ucsb.edu/ws/?pid=47232>; Ruth Marcus and Ann Devroy, "Asking Americans to 'Face the Facts,' Clinton Presents Plan to Raise Taxes, Cut Deficit," *Washington Post*, February 18, 1993, <https://www.washingtonpost.com/archive/politics/1993/02/18/asking-americans-to-face-facts-clinton-presents-plan-to-raise-taxes-cut-deficit/ea0bbc2b-40da-494c-b3af-db3d57ce9e02/>.

¹²⁵ Nelson Lichtenstein, "A Fabulous Failure: Clinton's 1990s and the Origins of Our Times," *The American Prospect*, Winter 2018, <https://prospect.org/health/fabulous-failure-clinton-s-1990s-origins-times/>.

sunrise industries, the Clinton administration worked to expand internet accessibility to “underdeveloped regions”—areas mostly defined as Rustbelt and rural enclaves—as a way to give market access to millions of Americans who had yet to find employment under the New Economy.¹²⁶ Despite its many shortcomings regarding adequate focus on the poor, mass incarceration, and banking deregulation, Clinton’s policies were supported by the electorate, winning him both reelection and allowing him to safely rebuke impeachment proceedings.¹²⁷

The Tax Reform Act of 1986 was not just another Reagan “tax cut” bill. It was an effort by the Democratic Party to create a new political platform that incorporated lessons of 1984, while still attempting to create opportunities for Americans beyond the postwar industrial economy. The eliminations of multiple tax loopholes sought to bring equality to an economy increasingly dominated by financial trickery over stable investment and growth. A new focus on research and technology was believed to provide growth and opportunity to the next generation of the middle class. The policies put forth by the Democrats in TRA86 did not concede ground to the Reagan Revolution as much as endeavor to reform the Democratic Party to attend to the demands of a new economic and political era.

However, the 1980s began the long period of increasing inequality and decreasing opportunity for millions of Americans that continues to this day. Despite the goals behind the tax bill, critique of TRA86 is deserved. James Galbraith investigated how two

¹²⁶ Lily Geismer, “Let Them Eat Tech,” *Dissent* (Fall 2019), 48-57.

¹²⁷ John F. Harris, *The Survivor: Bill Clinton in the White House* (Random House, 2006); Jeffrey Toobin, *A Vast Conspiracy: The Real Story of the Sex Scandal That Nearly Brought Down a President* (Touchstone, 2000); Derek Chollet and James Goldgeier, *America Between the Wars: From 11/9 to 9/11 (The Misunderstood Years Between the Fall of the Berlin Wall and the Start of the War on Terror)* (Public Affairs, 2009).

unexpected consequences of TRA86 fueled inequality. First, TRA86 did not eliminate the mortgage interest rate deduction. This created an incentive for people who wanted to take out loans to do so through housing. Furthermore, a remarkable high percentage of “windfalls” from the tax cut were invested in mansion building. Taken together, real estate values were artificially inflated, creating the incentive to expand the mortgage market ever further until even men and women with no jobs, income, or assets were targeted by predatory lenders. The resulting bust of the real estate bubble in 2008 led to a loss of nearly one hundred billion in assets just for minority home owners, further increasing wealth inequality.¹²⁸

Secondly, the decrease in the top marginal personal income rate created the incentive to increase take-home pay over benefits. As Galbraith states, “when you reduce the tax rates on personal incomes, people who controlled corporations and controlled their own compensation as executives had a strong incentive that wasn’t there before to transfer income from the company to themselves” thus creating “the executive compensation boom” that has furthered inequality.¹²⁹ Thomas Piketty has also concluded that if CEO’s tax rates are exceptionally high it is not worth the hard-bargaining process to raise income, as any increase in wages will mostly go to the government. Therefore, lower tax rates for individuals incentivize more aggressive bargaining. Tax cuts’ contribution to widening inequality is not only measured by its static contribution to how

¹²⁸ “James K. Galbraith: How Inequality Happened” *90.9wbur Public Radio*, May 21, 2012 <http://radioopensource.org/james-k-galbraith-how-our-inequality-happened/>; Galbraith, *The End of Normal*, 80-81, 149-68; James K. Galbraith, *Inequality and Instability: A Study of the World Economy Just Before the Great Crisis* (Oxford University Press, 2012), 148-49; Kotz, *Rise and Fall of Neoliberal Capitalism*; Hyman, *Debtor Nation*, 220-88.

¹²⁹ “James K. Galbraith: How Inequality Happened.”

much more money CEO's take home; they also have dynamic effects that play out over time, multiplying the initial boost to inequality.¹³⁰

Despite the well-documented detrimental outcome of cutting top marginal rates, historians must not oversimplify the complicated process of forming and passing legislation when studying the development of American neoliberalism and economic inequality. Most of the architects of TRA86 sought to design a tax policy to attend to the urgent needs of the lower and middle class.¹³¹ In order to get bipartisan support from key members of the opposition party who controlled the Senate and the Presidency, some compromise—in the form of lowered top rates—was implemented. The historic problem of increasing economic inequality was not simply the result of the top rate tax cuts in TRA86. Rather, true failure rests in the inability to fully address problems created by legislation as they became apparent in the following decades. Although both H.W. Bush and Clinton raised taxes, more expansive attempts at tax reform have faced an increasingly revanchist Republican party that attacked any and every effort to raise taxes. Republican leadership has continued to view tax cuts not as one tool in the box, but as *the only tool*.¹³²

The motivations behind, and results of, TRA86 must be taken together in order to fully understand the changing political economy of the 1980s. Over simplistic analysis of

¹³⁰ Thomas Piketty, Emmanuel Saez, and Stefanie Stantcheva, “Optimal Taxation of Top Labor Incomes: A Tale of Three Elasticities,” *American Economic Journal: Economic Policy* 2014 (Volume 6, Issue 1), 230-71.

¹³¹ Joseph Pechman, the director of the Brookings Economic Studies program, progressive-minded economists, and a major figure in the 1986 tax reform effort stated: “Some people have criticized the 1986 Act on the grounds that it has not increased progression enough . . . I agree with this criticism. However, it would have been foolhardy to try to revise the tax base and increase progression much more . . . if taxed at excessively high rates, the rich will seek out loopholes explicitly or implicitly designed for their benefit. It is a far better strategy to eliminate the loopholes first and expose the real effective tax rates applying to the top incomes.” See Joseph Pechman, *Tax Reform, the Rich and the Poor* (Brookings Institution, 1989), 90-91.

¹³² Andrew Rosenthal, “Bush Now Concedes A Need for Tax Increases to Reduce Deficit in Budget,” *New York Times*, June 27, 1990; Wilentz, *The Age of Reagan*, “The Politics of Clintonism,” 323-54.

tax policy that only focuses on one aspect of the legislation creates a false narrative, attributing too much power to too few people. Furthermore, the continued use of the Reagan Revolution to answer all things economic in the 1980s obfuscates the intricacies of a decade that was marked by shifting political alliances, new understandings of the economy, and most of all, political realignment for both parties.

By the early 1980s, the pillars of the postwar political economy—ROI, industrial manufacturing, and employment—had radically transformed. President Reagan and New Democrats attempted to course correct through the tax code. However, the radical changes wrought by the Volcker Shock and financialization could not be so easily tamed. In fact, the changes to the tax code in 1981 not only failed to stimulate long-term industrial investment, it led to massive speculation in the real estate industry. But what does this mean, on the ground? Can speculation be used for productive good, even if the results are seemingly useless empty buildings? How did imagination become increasingly untethered from reality throughout the era? The next chapter, centered on the Savings & Loan Crisis, investigates these ideas, elucidating complexity of financialization. Most importantly, the S&L Crisis offers an opportunity to introduce how financial production emerged in the 1980s.

Chapter 3

The Virtue of Liquid Buildings: The Savings and Loan Crisis of 1986 and the Financial Production of Real Estate

By 1984 Danny Faulkner had achieved a rags-to-riches story normally found only in fiction. As the son of “a cotton sharecropper,” who was raised “in a rundown wood-frame house . . . [and] unable to read or write” due to undiagnosed severe dyslexia, Danny worked menial odd jobs through his early adulthood until he was hired to paint the apartment of a wealthy real estate developer, Kenneth Murchinson. Impressed with Danny’s people skills and work ethic, Murchinson “taught Danny how to set up his own business and loaned him \$50,000,” which quickly resulted in a successful painting business.¹

In 1979, Faulkner “decided to sink some big money into real estate and the land-development.” All the condos quickly sold, making Danny a millionaire. Over the course of the next three years, Faulkner developed hundreds of condos in I-30 corridor of the Dallas suburbs. As his wealth grew, apparently so did his heart. Throughout a profile in a Dallas-centric magazine, Danny Faulkner is described as a “solid Rowlett [county] citizen.” Although Faulkner enjoyed his “nouveau riche lifestyle” by “laying out millions of dollars for such amenities as helicopters, a Lear jet, several Rolls-Royces, his own newspaper, a ranch, expensive jewelry, lavish social affairs—even a million-dollar circle suite at Texas Stadium,” he also was “so good-hearted . . . that he likewise has parted with some of his millions for charitable causes: his church, the needy and the sick. He has always been a man known to open his wallet when his heart is touched—even for a stranger he might meet on the street.”²

¹ Eric Miller, “Trouble in Dannyand: High-rolling, Holy-Rolling Faulkner made a fortune in condos. But how?,” *D Magazine*, February 1, 1984, <https://www.dmagazine.com/publications/d-magazine/1984/february/trouble-in-dannyland/>.

² Miller, “Trouble in Dannyand.”

Faulkner's virtue was undeniable. "He loves his family, goes to church every Sunday and takes the time to touch people's lives in a positive way." Friends attested:

he contributed \$1 million to the Jupiter Road Baptist Church for a new sanctuary because he was saddened when the daughter of a fellow church member died of leukemia. And there was the time he saw a woman and her child collecting cans in a roadside ditch and pulled off the road to give them several crisp \$100 bills.

Gregarious and kind, "every Faulkner yarn seems to have a moral; he rarely misses a chance to make some down-home philosophical statement."³

Yet, there was something rotten in "Dannyland." The wealth that made him a pillar of the community was based in fraud. In the early 1980s, Danny Faulkner began working with the Empire Savings and Loan Association of Mesquite, Texas. Through this savings and loan company, Faulkner invested in "hundreds of unusual land sales," resulting in "inflated land appraisals and more than \$500 million in questionable real estate loans." The I-30 corridor was "glutted . . . with a potential 12-and-one-half-year supply of condominiums" that were almost all empty. Despite supply far outpacing demand, the condos were central to a "a pattern of swaps of large tracts of land among a 'small network of interrelated developers[,]'" which resulted in artificially inflating the price of land far above usual market rates."⁴ By 1985, Empire Savings and Loan Association, and Danny

³ Miller, "Trouble in Dannyand."

⁴ Miller, "Trouble in Dannyand."

Faulkner, were embroiled in one of the largest real estate collapses in U.S. history, resulting in a federal investigation and prison sentences.⁵

The Empire Savings and Loan scandal is now considered the harbinger of the larger Savings & Loan Crisis that rocked the nation in the second half of the 1980s. In many ways, Danny Faulkner's tale reflects the crisis at large. Savvy investors took advantage of lax regulation and schemed their way to millions of dollars, leaving fraudulent investments and empty buildings in their wake.

However, Faulkner's story also illuminates how many perceived these investors, before the fraud became clear. Real estate has long been central to the American political economy. By the 1980s, Savings & Loans were central for making dreams of homeownership obtainable to millions of working- and middle-class families for over a century. Investors like Danny Faulkner used these same institutions to manipulate real estate financing, becoming incredibly rich in the process. But yet, for a time, they were moral leaders. Pillars of the community. Examples of the new virtuous producers of the era of financialization, before it all came crashing down in 1986.

This chapter focuses on three fundamental concepts of how financial production transformed real estate during the 1980s. We begin with how both the Carter and Reagan administrations responded to the disaster that the Volcker Shock wrought on the savings and loan industry (S&L). Beginning in the 1930s, New Deal legislation heavily regulated the interest rates that S&Ls could offer on mortgages in order to ensure affordable home loans to the American middle class. The high interest rates caused by the Volcker Shock effectively starved the S&L industry of investment capital, causing many to fail. In response, both the Carter and Reagan

⁵ Miller, "Trouble in Dannyand"; Chip Brown, "Faulkner, Others Convicted In I-30 Condo Trial, Others Convicted In I-30 Condo Trial," *Ap News*, November 6, 1991, <https://apnews.com/article/9738c82d48d53b1eac51b65cc968f712>.

administrations drastically deregulated the industry, allowing S&Ls to compete with other investment institutions. This move is rather unsurprising. After all, the motto of the Reagan administration was to release the “magic of the market” through deregulation. However, the central motive for deregulation—the reason why Democrats in Congress passed these bills—was to save the cultural cornerstone that was the S&L industry. Savings and loans were not normal investment banks. Since the 1830s, S&Ls were integral to creating “virtue” in the American political economy by providing affordable housing to select hard-working Americans, thus making them property owners. Therefore, the deregulatory response to the Volcker Shock was not a purely driven by free market ideology, but rather a bipartisan effort to maintain an arbiter of American virtue—home ownership.

Deregulation appeared to have saved the S&L industry. However, the solution to one crisis sparked another as deregulation opened the floodgates to highly speculative schemes that effectively funneled money through the real estate market. This brings me to my second concept—deregulation made real estate central to the new financialized economy. In a financialized economy, most profits are not made by producing goods, but rather made by investing in assets that will grow in value over time. Real estate had always been a key asset for investment. However, the transition to financial production fundamentally transformed real estate. Buildings themselves became a type of liquid capital as value was no longer ascribed to what that building materially produced, but to what some future buyer would pay for it, creating an investment opportunity to borrow against the future price of the asset in order invest in immediate speculative endeavors. It mattered little whether the building was needed—if there was demand for ever more condominiums in the outskirts of Dallas. Rather, investment in new construction was spurred by various incentives made possible through financialization—from the

most basic idea that American real estate values always grew over time, to more complicated incentives involving tax breaks, high-risk investment schemes, and even out-right fraud.

This model eventually came crashing down in 1986, creating the S&L Crisis at the heart of so many studies. My final concept focuses on the federal government's response to the second crash of the S&L industry: the federal government became the insurer of last resort. This is a subtle, but important shift on the standard implementation of "investor of last resort" where the federal government responds to recessions with deficit spending in order to "prime the pump" to get production and consumption back on track. Within a financialized economy, the government's role shifted from investor to insurer. Every loan made by the S&L industry was backed by the Federal Savings and Loan Insurance Corporation. Once S&L branches began to default, the federal government—meaning the American taxpayer—essentially bought the bad loans. The industry was not allowed to collapse because they were the new producers of American economic growth. If memories of "too big to fail" and TARP are flashing through your mind, you are not wrong. The federal government's solution to the 1986 crisis remains our current political economy—stabilize the financial industry by buying bad loans, spurring continued investment and speculation in order to keep the financial heart of the American economy growing.

By the late 1970s, a model of slow, stable profits from household mortgages had profitably sustained the Savings & Loan industry for nearly 150 years. This system ended abruptly in 1979. In August of that year, President Carter's recently appointed Federal Reserve (Fed) Board Chairman, Paul Volcker, announced that to counter inflation the Federal Reserve would no longer control interest rates, instead focusing on managing the money supply. No

longer the subject of Fed control, the benchmark Federal Funds rate rose from just over 10 percent in July of 1979 to almost 18 percent in April of 1980, and reached as high as 19 percent in January of 1981.⁶

For the S&L industry specifically, the Volcker Shock brought doom. A key New Deal policy, Regulation Q, capped the S&L interest rate offered to savings deposits at 5.5 percent. Accordingly, investment moved away from this regulated low interest return to unregulated markets, like money-market mutual funds, that benefited from high returns due to the astronomical Federal Fund interest rates.⁷ Financial markets that did not have a regulatory cap grew from \$9.5 billion in assets in 1978 to more than \$236 billion by December of 1982. Savings and loans could not compete with the high returns offered in money-market accounts due to the limitations of Regulation Q. Deprived of investment funds, S&Ls were in an economic death spiral.⁸

This first wave of S&L bankruptcies could be blamed on federal government regulation. This seemingly supports the ascendent view of the era that overregulation was destroying the country's once robust economy. However, the dynamics of Regulation Q and its effects on the economy, and American society broadly, merit a deeper analysis.

During the Great Depression, the S&L industry faced complete collapse. Many depositors—meaning Americans who invested their savings into S&Ls—were forced to tap into their savings in order to pay for food, housing, and other necessities in order to survive. Savings and loans began to strain under the pressure of these withdrawals. Because S&Ls did not offer

⁶ “Inflation: The Great Saver Rip-Off,” *Savings and Loan News* 100 (August 1979), 47; Federal Reserve Bank, St. Louis, *FRED II*, <http://research.stlouisfed.org/fred2>.

⁷ Money market accounts invested in treasury notes and commercial paper, both of which grew in value due to the high interest rates induced by the Volcker Shock.

⁸ Federal Home Loan Bank Board (FHLBB), *Agenda for Reform, A Report on Deposit Insurance to the Congress* (Washington, D.C.: FHLBB, March 1983), Chart 1b; James R. Barth, *Special Analysis: The Great Savings and Loan Debacle* (American Enterprise Institute for Public Policy Research, 1991), Table 3-1, 26-27, 38.

immediate payable liabilities (you could not immediately withdraw your savings because it was invested in mortgages), they held few liquid assets and capital—meaning that S&L did not have a large reserve of cash on hand.⁹ In fact, most state laws required S&Ls to distribute earnings in real estate home mortgages in order to keep said mortgages affordable to qualified Americans. Withdrawals continued to mount (you were entitled to your money after an agreed upon time, usually 2-4 weeks, written into the deposit contract), creating record failures within the S&L industry, sharply restraining the funds available for housing, thus further exacerbating the economic crisis.¹⁰

In response, the federal government began to implement a series of reforms. In 1932, President Hoover signed the Federal Home Loan Bank Act that established the Federal Home Loan Bank System. This new national organization gave member S&Ls “access to a reliable and steady source of funds during turbulent times to promote home ownership without disruptions.”¹¹ In return for adhering to federal government oversight, S&Ls could receive funds from the regional federal banks, creating a system much like the Federal Reserve Banking system. Local S&Ls were able to receive investment from a wider geographic range of sources, essentially securing local loans through a larger pool of capital. This action brought confidence back to local S&Ls by ensuring that they were “solvent and reasonably safe credit risks.”¹²

Franklin D. Roosevelt continued Hoover’s precedent of direct government intervention and regulation into the home mortgage marketplace. In June of 1933, FDR signed the Home Owner’s Loan Act. This bill allowed the Federal Home Loan Bank Board (FHLBB) to charter

⁹ This concept is dramatically played out in *It’s a Wonderful Life*. As Jimmy Stewart explains in the famous bank run scene, the money was not “here” in the S&L, it was “in Tom’s house” in the form of mortgages. *It’s a Wonderful Life*, Blu Ray, directed by Frank Capra (1946; RKO Radio Pictures, 1946, Paramount Pictures, 2009).

¹⁰ H. Morton Bodfish, *History of Building and Loans in the United States* (U.S. Building and Loan League, 1931), 7; Barth, *The Great Savings and Loan Debacle*, 14-15.

¹¹ Barth, *The Great Savings and Loan Debacle*, 15 [emphasis added].

¹² H. Morton Bodfish and A. D. Theobald, *Savings and Loan Principles* (Prentice-Hall, Inc., 1940), 301; Barth, *The Great Savings and Loan Debacle* 15-16.

and regulate the operations of federal savings and loans. FDR also signed two bills that addressed the need for federal insurance and interest rate regulation. Title IV of the National Housing Act created the Federal Savings and Loan Insurance Corporation (FSLIC) in 1934. Like the Federal Deposit Insurance Corporation (FDIC), the FSLIC provided capital reserves in the form of insurance payments for member FHLBB savings and loan institutions. This measure alleviated the main shortcoming of S&Ls in times of panic by providing liquid capital when shareholder members withdrew their funds *en masse*.¹³

Paralleling the creation of federal insurance, Regulation Q was designed to bring stability and security to the banking sector. Federal regulators believed that the Great Depression created competition for deposits and consequently drove down the difference between lending and borrowing interest rates. The resulting low borrowing rates had encouraged highly speculative behavior by large banks, creating a string of failures in 1931 and 1932. Regulation Q solved this dilemma by enforcing federally controlled caps on deposit insurance—the 5 percent limit of 1979. Stable long-term profits were achieved at the cost of speculation and short-term gain.¹⁴

Thus, one of the reforms to save the S&L industry in the 1930s was causing its demise fifty years later. At this point, you may be noticing a pattern. The S&L industry sure seems prone to complete collapse. Why did the federal government continue to ensure its survival? The key to that answer lies in the “virtue” of home ownership in American culture. During the nineteenth century, westward expansion, underpinned by violence against Native peoples by the U.S. military, brought land to the American marketplace.¹⁵

¹³ Barth, *The Great Savings and Loan Debacle*, 16.

¹⁴ Andrew S. Carron, *Studies in the Regulation of the Economy: The Plight of the Thrift Institutions* (The Brookings Institution, 1982), 5-11; Barrie W. Wigmore, “A Comparison of Federal Financial Remediation in the Great Depression and 2008-9,” *Research in Economic History* 27 (2010): 255-303.

¹⁵ Bruce Cumings, *Dominion from Sea to Sea: Pacific Ascendancy and American Power* (Yale University Press, 2009); Richard White, *Railroaded: The Transcontinentals and the Making of Modern America* (W.W. Norton, 2011).

Urban expansion soon followed. By 1830, the populations of Philadelphia and New York had grown by 380 and 595 percent, respectively. City housing steadily rose in cost, and because many of these new arrivals had limited or no means of saved capital, outside financing became necessary.¹⁶ Thus, by the mid-nineteenth century, townships across urban America formed “Buildings and Loans”—the for-runners to savings and loans—in order to enable property ownership to the growing class of American wage laborers. Local communities would pool savings and distribute loans to qualified families. Qualifications were rather subjective, relying on the character of the applicant.¹⁷

By the 1870s, the model was promoted on a national scale to address the rising divisions between capital and labor. In 1869, Edmund Wrigley wrote *The Working-Man’s Way to Wealth*. This best-selling publication focused on the principles of successful S&Ls that served as a “how to” guide for organizing associations, and most importantly, attended to rising economic inequality by declaring that “the building association is the only plan by which the working man can become his own capitalist.” Home ownership, secured through labor savings and community support, was thought to provide the means to transform wachelings into investors and propertied capitalists.¹⁸

Building & Loan associations played a critical role in communities underserved by private banking throughout the latter half of the nineteenth century into the early twentieth. For example, in Chicago local associations played a vital role for working class ethnic enclaves to achieve home ownership. Polish, Czech, Italian, Swedish, and Lithuanian neighborhoods

¹⁶ Kenneth T. Jackson, *Crabgrass Frontier: The Suburbanization of the United States* (Oxford University Press, 1985), 115-27.

¹⁷ Mason, *From Building Loans to Bail-Outs: A History of the American Savings and Loan Industry, 1831-1995* (Cambridge University Press, 2004), 12-39.

¹⁸ Edmund Wrigley, *The Working-Man’s Way to Wealth: A Practical Treatise on Building Associations; What They Are and How to Use Them*, 5th Edition (J.K. Simon, 1872), 1-2; Edmund Wrigley, *How to Manage Building Associations*, (J.P Lippencott, 1894), vii-viii; “Building Associations and Savings Banks,” *Gunton Magazine* Vol. 10 (April, 1896), 246-7; Mason, *From Building Loans to Bail-Outs*, 24-28.

successfully pooled money in order to build and purchase homes, alleviating reliance on crowded tenement style living conditions. By 1893, Chicago had nearly 500 associations serving its numerous neighborhoods.¹⁹

Just as importantly, local associations were formed in Black neighborhoods throughout the early twentieth century. For example, in 1934, a group of Black leaders—notably Robert Taylor, who would later become chairman of the Chicago Housing Authority—pooled \$7,000 to open Illinois Federal Savings and Loan to serve Chicago’s South Side. Redlining effectively prevented any investment from the few white-owned banks that contemplated serving the area by deeming the entire swath of the South Side as “high risk.” Though rates of homeownership lagged well behind those of white communities, Illinois Federal managed to give access to affordable mortgages, creating a higher-than-average rate of homeownership in Bronzeville and other surrounding neighborhoods.²⁰

Saving, investment, and property ownership were promoted to instill virtue in the expanding working class. Under this ideal, wage workers would not waste their incomes on petty entertainment and booze, but would rather follow a virtuous path of saving and investing in property. Of course, one could argue that this system successfully tethered the proletariat to their employers, thus ensuring their continued exploitation in the wage system in order to pay off their mortgages. But yet, the simple economics and “social good” of the associations ensured their popularity with both the small depositors and members of the American political and economic elite.²¹

¹⁹ Barth, *The Great Savings and Loan Debacle*, 8-14.

²⁰ Illinois Federal Savings & Loan continued to serve its mission for the next seventy years. However, 2008 marked the beginning of dire financial strains on the association. Its future remains uncertain. See Mick Dumke, Haru Coryne, and Mariam Elba, “What’s Gone Wrong At Chicago’s Last Black-Owned Bank?,” *Block Club Chicago* in association with *ProPublica*, December 21, 2021, <https://blockclubchicago.org/2021/12/21/whats-gone-wrong-at-chicagos-last-black-owned-bank/>.

²¹ Wrigley, *The Working-Man’s Way to Wealth*.

Since the 1830s, local municipalities, states, and the federal government had taken steps—sometimes drastic ones following the depressions of 1893 and 1929—to ensure that wage earners could become property owners. The 1980s was no different. On April 1st of 1980, Congress enacted the first major financial reform since the 1930s. The Depository Institutions Deregulation and Monetary Control Act (DIDMCA) answered President Carter’s call to “reform [the] system which has become increasingly unfair to the small saver”—Americans who mostly invested S&Ls.²² Mirroring the original motivation of S&Ls to help low-waged workers enter capitalist property ownership, assisting small savers became a socially useful mantra for political economic change.²³

The congressional effort to help small savers began a fundamental transformation of S&Ls as DIDMCA ended many regulations that kept S&Ls narrowly bound to low-interest mortgage market. The bill allowed savings and loans to offer interest-bearing negotiable order of withdrawal (NOW) accounts, charge cards, and trust services, greatly expanding the type of assets and financial services that can be held and offered by S&Ls. More importantly, S&Ls began to transform from locally controlled and focused entities as DIDMCA allowed S&Ls to operate statewide branches that were exempted from their state usury laws, and expanded their power to create acquisition and development loans. Finally, regulations on the types of loans S&Ls could offer were reduced as up to 20 percent of held assets could be a combination of

²² *Message from the President of the United States Transmitting His Recommendations for Comprehensive Financial Reform Legislation* (Washington, D.C.: USGPO, May 22, 1979), 1-3.

²³ U.S. Congress, Senate, Committee on Banking, Housing, and Urban Affairs, *Oversight hearings on Depository Institutions Deregulation Committee*, 96th cong., 2nd sess., July 2, 1980, 2-6; Thomas F. Cargill and Gillian G. Garcia, *Financial Deregulation and Monetary Control: Historical Perspective and Impact of the 1980 Act* (Hoover Institution Press, 1982), 33-40; “Strong Currents are Changing the Shape of Financial Markets,” *Savings Loan News* 100 (August, 1979), 40-46; Kenneth Thygerson, “Financial Change: Have Reformers Overlooked the Real Issue?” *Savings Loan News* 100 (October, 1979), 98-109; Littlewood, Shane, & Co., *The Depository Institutions Deregulation and Monetary Control Act of 1980: An Analysis and Interpretation* (Bank Administration Institute, 1981), 3-8.

consumer loans, commercial paper, and corporate bonds. The federal government explicitly backed this new model of S&Ls by increasing the coverage for deposit insurance from \$40,000 to \$100,000 per account, creating a scenario where most new accounts were almost 100 percent covered by federal insurance.²⁴

In total, S&Ls began to shift from the 150-year-old model based on the stability of small savers and local mortgage markets into the more speculative market of credit cards, commercial buildings, and corporate bonds. Though statewide offices and usury exemptions created a greater capital pool from which to draw upon, these changes broke community ties to local branches. In short, savings and loans began to look a lot more like national investment banks that relied on immediate financial growth rather than the originator of loans to the small savers of the working and middle class.

However, the intention behind these changes was to save the S&L industry, not radically transform it. The Volcker Shock had ended the New Deal era model for the industry; DIDMCA was thought to be a policy that would reinvigorate this model for the future. Deregulation provided access to new capital flows outside of home finance. However, these sources were capped at 20 percent in order to ensure that commercial and consumer loans were used to subsidize S&Ls' primary mission of home mortgages. Insurance was increased, but that was a general trend since 1978.²⁵ Congress, in fact, denied efforts made by the main lobbying arm of the S&L industry, the U.S. League of Savings Institutions (the League) to change a vital rule for the industry: the ability to offer variable-rate mortgages. Legislators felt that this change was

²⁴ *Leveling the Playing Field: A Review of the DIDMCA of 1980, and the Garn-St Germain Act of 1982* (Federal Reserve Banks of Chicago, 1983), 7-26; "Thrift Units Win Wider Credit Powers," *New York Times*, July 4, 1980, D1, D5; "The Thrifts Tip-Toe into Credit Cards," *Business Week*, September 29, 1980, 72; "S&Ls Get Ready to Kick Up Their Heels," *US News and World Report*, September 29, 1980, 17-18.

²⁵ Federal Deposit Insurance Corporate (FDIC) Decision of Research and Statistics, *History of the Eighties – Lessons for the Future*, vol. I (Washington, D.C: FDIC, 1997), 93-4. Congress increased the insurance of IRA and Keogh retirement funds by the exact same amount of \$40 to \$100 thousand in 1978.

“intellectually indefensible” as S&Ls main role in the American society was to offer stable, low-interest mortgages. Variable interest rates, while offering more profits to S&Ls, were believed to be against the moral role that S&Ls played in American society. Thus, the industrial era model of providing affordable mortgages to waged labor—to expand the propertied class—was the main reason behind the congressional action that led to the passage of DIDMCA.²⁶

Despite congressional efforts to reform the industry through new investment strategies, the S&Ls continued to deteriorate. The high interest rates of the Volcker Shock nearly zeroed out demand for new home purchases across the country, no matter what entity was the originator of mortgages. Between 1979 and 1980, new S&L mortgages fell by 25 percent. A year later, S&Ls were creating half as many mortgages as 1978. Even S&Ls that were taking on new depositors were still stuck with assets mostly composed of low-rate mortgages that severely limited their ability to turn a profit.²⁷

Take for example Standard Federal Savings and Loan Association of Troy Michigan, one of the largest home loan lenders in the state. In 1981, Standard Federal was:

paying an average 11.4 percent for deposits, while its loans—almost entirely fixed-rate, 30-year mortgages—were earning about 10 percent. With its expenses exceeding its revenues, Standard Federal began losing money for the first time since it

²⁶ U.S. Congress, Senate, Committee on Banking, Housing, and Urban Affairs, *Depository Institutions Deregulation Act of 1979*, hearings on S. 1347, 96th Cong., 1st sess., part 3, June 21, 1979, 131.

²⁷ National Commission on Financial Institution Reform, Recovery and Enforcement (NCFIRREE), *Origins and Causes of the S&L Debacle: A Blueprint for Reform* (NCFIRRE, July 1993), 29-30; “The Cost of Inflation Strikes Home,” *New York Times*, May 14, 1981, 26; Alan S. Oser, “America’s Dream Adrift,” *New York Times*, June 20, 1982, R7, R14

was founded in 1893. Its net worth dropped to \$109 million from \$138 million.”²⁸

Income from loans issued from as far back as the 1960s were not exceeding, or even matching, the cost of then current interest rates on deposits.

Savings and loans needed access to immediate capital. Although DIDMCA created means to acquire profit from diversified investment opportunities, this strategy would take years to achieve profit. And that is only if account managers implemented these new schemes. In 1980, the S&L industry was not one of high risk and speculation. Most people who worked in new account origination had only known one type of investment strategy, and were wary of any new schemes, even in the face of financial collapse. As one finance manager told the *New York Times*, most S&L lenders were “not eager to jump into new fields when old-timers were already having trouble earning a profit.”²⁹ Lending to areas outside of home finance was seen as risky and foreign; not something one did in an industry built on slow and practical long-term growth.³⁰

By 1981, the failure rate within the S&L industry reached levels not seen since the Great Depression. It is important to note the extent of the economic crisis the nation faced in 1981. Farm failure, unemployment, and lack of financial investment—seen here specifically within the housing market—all neared or surpassed numbers not seen since the 1930s. It was a moment of urgency. Old solutions were not working.³¹

²⁸ Eric N. Bergjan, “Rise of a National Mortgage Market,” *New York Times*, January 22, 1984, <https://www.nytimes.com/1984/01/22/business/rise-of-a-national-mortgage-market.html>.

²⁹ “Thrift Units Cautious on Expansion Plans,” *New York Times*, January 12, 1981, D1.

³⁰ “The Cost of Inflation Strikes Home,” *New York Times*, May 14, 1981, 26; Alan S. Oser, “America’s Dream Adrift,” *New York Times*, June 20, 1982, R7, R14; “The Thrift Crisis the Result of High Rates and Bungled Deregulation,” *Savings Loan News* 103 (April 1982), 44-48.

³¹ Federal Home Loan Bank Board (FHLBB), *Agenda for Reform, A Report on Deposit Insurance to the Congress* (Washington, D.C.: FHLBB, March 1983), Chart 1b; “How a Crisis is Speeding Deregulation,” *Business Week*, May 31, 1982.

Enter Ronald Reagan. Reagan, along with many key Republican congressional leaders, offered a clear and simple solution to the crisis: free markets. The collapse of the cornerstone of industrial-era community building gave Republicans an opportunity to offer bold new solutions. Remember, these solutions did not just appear out of thin air. Historians have explained how inflation and industrial profit loss led to the rise in clout of neoclassical economic theory.³² Coupled with the long-term agenda of pro-corporate propaganda, the mantra of free markets gained academic and political legitimacy throughout the 1970s.³³

What is most interesting about the S&L crisis is that unlike farming, unemployment, or tax reform, the collapse of the savings and loan industry was, in fact, bound to government regulations—as we have seen specifically with Regulation Q. Although legislatures sought to attend to the negative effects of Regulation Q with DIDMCA, the continued collapse of the S&L industry gave fuel to the new Republican-controlled Senate to create completely open financial markets. Senate Banking Committee Chairman, Jake Garn (R-UT), introduced legislation that sought to dramatically reform the S&L industry by further expanding lending powers to S&Ls. Though the House remained in Democratic control, a majority sought to attend to the beleaguered industry. After two weeks of deliberation, the Garn-St. Germain Depository Institutions Act of 1982 was passed on October 15.³⁴

³² Angus Burgin, *The Great Persuasion: Reinventing Free Markets since the Depression* (Harvard University Press, 2012); Jennifer Burns, *Goddess of the Market: Ayn Rand and the American Right* (Oxford University Press, 2009); Philip Mirowski & Dieter Plehwe, *The Road from Mont Pelerin: The Making of the Neoliberal Thought Collective* (Harvard University Press, 2009).

³³ Kimberly Phillips-Fein, *Invisible Hands: The Businessmen's Crusade Against the New Deal* (W.W. Norton, 2009); Elizabeth A. Fones-Wolfe, *Selling Free Enterprise: The Business Assault on Labor and Liberalism, 1945-60* (University of Illinois Press, 1994); Judith Stein, *Pivotal Decade: How the United States Traded Factories for Finance in the Seventies* (Yale University Press, 2010); Monica Prasad, *Starving the Beast: Ronald Reagan and the Tax Cut Revolution* (Russel Sage Foundation, 2018).

³⁴ *Garn-St. Germain Depository Institutions Act of 1982 Conference Report*, 30-50; L. Richard Fischer, Elizabeth G. Gentry and Petrina M. E. Verderamo, *The Garn-St. Germain Depository Institutions Act of 1982: What's in It for You?* (Arlington, VA: The Consumer Bankers Associations, 1982), 64-69; "Garn Continued to Push for Thrift Bill," *Savings Loan News* 103 (August, 1982), 7; "Conferences Clear Bill to Shore Up Savings Industry," *New York Times*

Garn-St. Germain addressed the main shortcoming of DIDMCA by providing immediate relief to failing S&Ls. The bill authorized the FSLIC to create “net worth certificates” to S&Ls with a net worth of less than three percent of assets. These certificates acted as government promissory notes that the failing S&Ls could use to increase their equity. This rather simple solution effectively created a dynamic where the FSLIC made direct capital investments into individual savings and loans.³⁵

Let us take a moment to mull this over. Exactly like the Farm Crisis, the high interest rates caused by the Volcker Shock sent the S&L industry into a tailspin. And like the Farm Crisis, congressional legislation provided direct capital funds in order to save businesses that were essentially failing in a changing marketplace. However, there was no “S&L Aid” designed to call attention to the beleaguered industry. In fact, Republicans—especially newly-elected members of the Senate who rode the Reagan wave of free market rhetoric—were as eager as Democrats to have the federal government directly intervene into the marketplace and save S&Ls. The preamble of the bill early states that the Federal government had come to the rescue of the failing industry: “[Garn-St. Germain is] An Act to revitalize the housing industry, by strengthening the financial stability of home mortgage lending institutions and insuring the availability of mortgage loans.”³⁶ Why did this happen? What is the difference between farmers and S&Ls?

September 30, 1982, A1, D16; Kenneth B. Noble, “Thrift Unit Aid Backed by Senate,” *New York Times*, September 25, 1982, 39, 42; Clyde H. Farnsworth, “Senate Bill Asks Bank Decontrol,” *New York Times*, October 8, 1981, D11.

³⁵ *Garn-St. Germain Depository Institutions Act of 1982 Conference Report*, 30-41; “New Options Offer Hope to Ailing Thrifts Capital Problems,” *Savings Loan News* 103 (June 1982), 5-8; Mason, *From Buildings and Loans to Bail-Outs*, 219.

³⁶ U.S. Congress, House, Garn-St. Germain Depository Institution Act of 1982, HR 6267, 97th Cong., 2nd sess., October 15, 1982, 1; U.S. Congress, House, Subcommittee on General Oversight and Renegotiation of the Committee on Banking, Finance and Urban Affairs, *Deregulation and the Federal Home Loan Bank Board*, 98th Cong., 1st sess., November 9, 1988, 2.

There is a two-fold answer to this mystery. First, unlike farmers, S&Ls were not debtors. In fact, they were creditors. The Volcker Shock affected their ability to receive investment, not pay back loans. This was a problem of supply—a key provider of credit had their capital supply snuffed out by high interest rates. It was a ready-made problem that the newly popular “supply-side” theory of economics could solve. Rather than being antithetical to free market dynamics, these Republicans believed that the government could play an active role in order to support business, and in this case, creditors, in order to create the goods to the American people (home mortgages).

Second, and most importantly, the Garn-St. Germain Act further deregulated the entire savings and loan industry. True, the high interest rates of the Volcker Shock could and were argued as a market force. However, Republicans blamed New Deal era government regulations as the main culprit behind the failure of so many S&Ls between 1979 and 1982. This was not necessarily an incorrect view as Regulation Q did limit the ability of S&Ls to compete for capital on the market. Consequently, Republicans led the charge against the then fifty-year-old legislation. The negative effects that Regulation Q had on the S&L industry also caused many Democrats to fall in tune with their free market Republican counterparts. After all, savings and loans were the cornerstone to middle-class homeownership, and thus should be protected from all threats—including federal regulations.

This rule change had an almost immediate impact on S&Ls across the country. The Standard Federal Savings and Loan Association of Troy, Michigan again offers a clear example. In 1982, the S&L began to issue

new mortgages more closely tied to prevailing interest rates. Largely as a result of its actions in the mortgage markets, the association

earned about \$30 million in 1983, has rebuilt the net worth it lost [\$29 million between 1981 and 1982] and has begun hiring new employees after a lengthy period of austerity.³⁷

Issuing mortgages at higher, market-rate interest allowed S&Ls to finally earn more from mortgages than what they had to pay out to depositors.

Garn-St. Germain ended all remaining Regulation Q controls. However, the bill did not stop there. Capital income was still recognized as a problem. Though the FSLIC scheme provided an immediate stopgap measure, the industry needed to expand its loan portfolio. The law attended to this in other crucial ways. Following the precedent of DIDMCA, S&Ls were allowed to hold up to 40% of assets in commercial mortgages (up from 20%). Furthermore, the industry could hold up to 11% of assets in secured and unsecured commercial loans, and 3% in equity business investments. Garn St.-Germain removed almost all restrictions on the types of consumer loans thrifts could issue. Rules regarding the industry's bread and butter product, home mortgages, were also loosened. Loan to value limits on mortgages were removed. Previously, S&Ls could only loan up to 85% of the home's market value. Now, S&Ls could offer up to *100 percent financing* to any borrower. No down payments were necessary. This in effect ended the 150-year history of S&Ls practice to encourage wage laborers to accumulate some financial savings before they were given access to credit. What began as an effort to help "small savers" effectively made them inconsequential to the home mortgage market.³⁸

³⁷ Eric N. Bergjan, "Rise of a National Mortgage Market," *New York Times*, January 22, 1984, <https://www.nytimes.com/1984/01/22/business/rise-of-a-national-mortgage-market.html>.

³⁸ U.S. Congress, House, House Committee on Banking, Finance, and Urban Affairs. Subcommittee on Financial Institutions Supervision, Regulation, and Insurance. *Garn-St. Germain Depository Institutions Act of 1982*, Report No. 97-899, 97th Cong., 2nd sess., 1982, 2-30; "What New Bank Law Does for Consumers," *US News and World Report*, October 10, 1982, 66-67; "Major Provisions of the Legislation," *New York Times*, October 1, 1982, D4; "Saving the Thrifts and Then Some," *New York Times*, October 1, 1982, A30; Lawrence J. White, *The S&L Debacle: Public Policy Lessons for Bank and Thrift Regulation* (New York: Oxford University Press, 1991), 67-74; Mason, *From Buildings and Loans to Bail-Outs*, 219-220.

Though Senator Garn led the bill's passage through Congress, the true force behind many of the key deregulatory changes was the new chairman of the Federal Home Loan Bank Board, Richard Pratt. Appointed by Reagan at the behest of Senator Garn, Pratt was a former U.S. League of Savings Institutions lobbyist. Years of battling New Deal era regulations that, according to Pratt, limited the ability of S&Ls to play a larger role in the American housing market, made him a true believer in the mantra of free markets. Although the League had some success in influencing DIDMCA policies, the appointment of one of the firm's former employees ensured that the new legislation would be heavily influenced by the lobbying arm of the S&L industry.³⁹

Pratt oversaw the implementation of two rule changes that dramatically reshaped the character of the S&L industry. In 1981, Pratt upended nearly 150-years of precedent by reducing the minimum number of shareholders required by law from 400 individuals (with no fewer than 125 from the local community) to *one*. Instead of a mutual bank, owned by the community and backed by the federal government, an S&L could be fully owned and managed by one person. This move was done to encourage new investors to purchase failing S&Ls. Furthermore, the change also allowed new buyers to use their existing real estate assets to secure 100 percent financing to buy thrift stock. This made it possible to become a sole owner of an S&L with literally no cash down; one simply borrowed against real estate assets they already owned.⁴⁰

³⁹ A League Executive claimed that Garn-St. Germain "wouldn't have happened without trade group support and wouldn't have passed without the support of the Reagan administration." See "Implementation of New Powers Awaits FHLBB, DIDC Rules," *Savings Loan News* 103 (November 1982), 7, 6-8. "Jonathan Fuerbringer, "Behind the Scenes, Perhaps a Coup," *New York Times*, November 15, 1983, A20; "Thrifts Enter a New Era," *Savings Loan News* 103 (November 1982), 36-42; Kenneth B. Noble, "Amid Debate, U.S. Panel Asks Wider Powers for Thrift Units," *New York Times*, February 26, 1982, D3.

⁴⁰ Alice P. White, *Evolution of the Thrift Crisis* (Division of Research and Statistics, Division of Monetary Affairs, Federal Reserve Board, 1989), 20; "New Associations Baby Members of a Better Business," *Savings Loan News* 103 (July 1982), 12-15.

The single most important change that the Pratt Board initiated transformed what can only be described as the most exciting aspect of the S&L industry: accounting rules. The sentiment behind this sentence is not completely in jest; although accounting rules can be somewhat dry and complex, a brief dive into the world of bookkeeping offers a direct example of how a key feature of financial production operates and a primary reason why the S&L crisis grew into catastrophe in the mid-1980s.

In early 1982, the Pratt Board permitted S&Ls to use Regulatory Accounting Principles (RAP) in financial statements reports to federal regulators. Up until that moment, S&Ls used Generally Accepted Accounting Principles (GAAP). The key difference between these two principles is that RAP is far more generous in how S&Ls are allowed to report equity, assets, income, and expenses. In short, the key components that tell regulators whether a thrift is making a profit or financially insolvent. For instance, if an S&L sold an asset—let’s say a commercial building—for a loss, GAAP would require the loss to be reported immediately. However, RAP allowed the S&L to spread that loss over ten years, and still carry the unamortized portion as an asset. So, if a S&L originated a mortgage for a building for \$100 thousand, but later had to sell the building for \$75 thousand, under GAAP it would report a net loss of \$25 thousand in the same fiscal quarter of the sale. Under RAP, that same \$25 thousand loss could be spread over ten years, or 40 fiscal quarters. For the sake of argument, the reported loss would shift from \$25 thousand in one quarter to \$625 per quarter for the next ten years, allowing S&Ls to cover the loss with the difference between the total loss reported and the original worth of the building.⁴¹

⁴¹ An effort to clarify: the loss under GAAP would be \$25K in one quarter. For RAP it would be reported as slow loss in value until the account zeroed out: \$100K minus (\$625 x the number of quarters since the sale) = the value of the asset. Bert Ely, *The Role of Accounting in the S&L Crisis*, Consultant Study No. 2 (National Commission on Financial Institution Reform, Recovery, and Enforcement Publications [NCFIRRE], 1993), 37; “Implementation of New Powers Awaits FHLBB, DIDC Rules,” *Savings Loan News* 103 (November, 1982), 8; “How S&Ls Can Hide Their Losses,” *Forbes* 128 (September 14, 1981), 159; Mason, *From Buildings and Loans to Bail-Outs*, 222.

This rule change operates with the same logic as the changing depreciation schedule seen in the previous chapter.

The change to RAP furthered Pratt’s plan to promote mergers as an essential step in saving the S&L industry. Under both GAAP and RAP, a merger created an intangible asset known as “goodwill.” Simply defined, “goodwill represents the difference between what a buyer pays for an asset and its market value.”⁴² With GAAP, S&Ls could report goodwill as a positive asset within their total net worth—it would be on the “black ink” side of their calculations. However, GAAP also required that goodwill to be amortized as an expense over ten years. This effectively added a line in the “red ink” section that, over time, would offset the initial gains. Thus, the goodwill asset would somewhat inflate the profitable asset side of the balance sheet, but would be neutralized within a decade. This was done to help facilitate a merger—but not to allow mergers become a means of profit.

The change to RAP upended this dynamic. Under RAP, the goodwill loss amortization period extended to forty years, while the initial gain remained at ten years. Again, we will use a hypothetical example to explain why this small change was so important. The high interest rates of the Volcker Shock caused many S&L’s loans to lose market value. As a reminder, these loans were capped at 5% interest, meaning the S&L could only charge 5% of the total loan, as compared to the new market price of nearly 19% for a loan. Therefore, these loans lost value as interest rates rose. When a healthy S&L merged with troubled one, the acquiring firm would re-evaluate the troubled firm’s assets and “write down” said assets to current market value. If the assets were worth less, an S&L was cheaper to buy. After acquisition, the loans issued by the old failing S&L were paid to the acquiring thrift.

⁴² Mason, *From Buildings and Loans to Bail-Outs*, 222.

So, now you have a situation where loans were devalued at the point of sale, but the same loans were being paid, creating new profits. When reporting to federal regulators, the *income* from these acquired loans was amortized over ten years. Conversely, the goodwill loss amortization was spread over forty years. Thus, the interest income gains exceeded the growth in expenses—the “red ink” amounts smaller than the “black ink” amounts. In the early summer of 1982, goodwill amounted to \$7.9 billion. By December of 1983 it had multiplied to \$30 billion, accounting for 90% of total RAP capital.⁴³ Goodwill, an intangible asset that once became a net zero on the record books, was now profit. Therefore, savings and loans could “literally ‘manufacture’ earnings and capital by acquiring other thrift[s].”⁴⁴ Finally, thrifts could leverage against these fictitious numbers, sometimes reaching as much as \$150 loaned for every \$1 of liquid assets—again, that \$1 was only on the books due to accounting rules changes. The shift to RAP created profits out of thin air, and facilitated the dramatic rise in thrift mergers that was a main goal of Pratt.⁴⁵

The use of RAP hid the true condition of the S&L industry. The numbers listed in the many postmortem reports are striking. If we use tangible net worth, a formula that excludes goodwill, 415 S&Ls (13% of the total S&Ls nationally) with \$220 billion in assets (32% of total industry assets) were still insolvent in 1982. Pratt’s Federal Home Loan Bank Board, however, used RAP, which fundamentally altered reported reality. Thus, the Board only reported 71 S&Ls

⁴³ Barth, *The Great Savings and Loan Debacle*, 50.

⁴⁴ FDIC, *History of the Eighties*, 174.

⁴⁵ U.S. Congress, Senate, Committee on Banking, Housing and Urban Affairs, *Hearings Before the Committee on Banking, Housing and Urban Affairs, of the United States Senate*, “Statement of Edwin J. Gray, Past Chairman Federal Home Loan Bank Board,” 100th Cong., 2nd sess. (August 2-3, 1988), 167; “Success in the New World May Depend on How Accountants Keep Score,” *Savings Loan News* 104 (January 1983), 50-55; NICFIRRE, *Origins and Causes of the S&L Debacle*, 38-39; “Biting the Old Loan Payment Today Could Mean Less Pain Tomorrow,” *Savings Loan News* 103 (February 1982), 43-46.

with \$13 billion in assets as insolvent, a small difference of 344 thrifts with \$207 billion in assets.⁴⁶

In 1983, Pratt's Federal Home Loan Bank Board declared victory over the crisis. When combined with Garn-St. Germain, Pratt stated that the federal government had created the conditions where weaker S&Ls were merged into profitable ones, giving the industry stability and growth going forward. Savings and loans, according to this vision, had navigated the troubled waters of the Volcker Shock and finally joined the ranks of the Reagan Recovery. The crisis, however, had just begun.⁴⁷

It is important to recount the fundamental changes that occurred within four short years. First, the Volcker Shock imploded a financial model that had worked for the S&L industry for almost 150 years. High interest rates drew investors—the savers of the economy—away from local S&Ls into more profitable ventures. Both the Carter and Reagan administrations sought to rectify this through deregulation. First, S&Ls were allowed to diversify their investments into more speculative markets, including consumer debt. Additionally, Regulation Q interest rate controls were eliminated, allowing S&Ls to charge higher interest rates in order to compete for capital investment with the broader financial marketplace. Both strategies attempted to create new sources of income to help save ailing thrifts.

Most importantly, neither Carter, Reagan, nor any member of Congress—regardless of party affiliation—suggested to allow the S&L industry fail. In fact, both the legislative and executive branches of government agreed that it was in fact governmental regulation that

⁴⁶ FDIC, *Managing the Crisis: The FDIC and RTC Experience, 1980-1994*, v. 1 (Washington, D.C.: FDIC, 1998), 795, 798, 803; Norman Strunk and Fred Case, *Where Deregulation Went Wrong: A Look at the Causes Behind the Savings and Loan Failures in the 1980s* (United States League of Savings Institutions, 1988), 6-9, 23; Edward J. Kane, *The S&L Insurance Mess: How Did It Happen?* (The Urban Institute Press, 1989), 24-30.

⁴⁷ "S&Ls in the Candy Store," *Forbes* 131 (June 6 1983), 44-45; "The Saving of the Thrifts," *Newsweek*, April 18, 1983, 59.

prevented S&Ls from competing within the market. The S&L industry was too important to lose. Its role dating back to the beginning of industrial capitalism to provide waged labor access to credit necessary for home ownership was not questioned. Property ownership through homeownership was still recognized as a cornerstone of American society, and as the best way, as Wrigley put it a hundred years earlier, to make the working man “his own capitalist.” The deregulatory actions of DIDMCA, Garn-St. Germain, and even Pratt’s FHLB were all done to ensure that S&Ls would continue their mission into the next century.

To further emphasize this point, we need to look no further than the federal government’s role as insurer for the S&L industry. For all the talk of free markets and deregulatory action, the federal government did not stop insuring thrifts through the FSLIC. In fact, government responsibility was expanded as coverage per account more than doubled from \$40 to \$100 thousand. The federal government, no matter which party controlled the executive or legislative branch, continued to influence the investment marketplace by offering guaranteed insurance for savings and loans.

Deregulation, then, was not to completely abandon the federal government’s role in supporting the S&L industry. Some controls were ended—most notably Regulation Q—in order to allow the industry to “grow out of their problem.” The mantra of growth, of course, was nothing new as the pursuit of economic growth came became a central and defining feature of U.S. public policy for both parties in the half-century after the end of World War II. Deregulation and an emphasis on the free market were just the latest example in the early 1980s as to how to best create a rising tide that would lift all boats.⁴⁸

⁴⁸ Robert M. Collins, *More: The Politics of Economic Growth in Postwar America* (Oxford University Press, 2000); David Pilling, *The Growth Delusion: Wealth, Poverty, and the Well-Being of Nations* (Tim Duggan Books, 2018).

But what is a free market? Sure, freeing S&Ls from investment controls and allowing them to raise their interest rates to market levels can be labeled as a free market strategy. But what about continued insurance to the point of almost being covered 100% by federal funds—in other words, taxpayers? Or a simple accounting change that suddenly made profits appear on the books. Is that free market growth? Pratt would of course answer yes. But we must recognize this for what it is: a mixed economy that has shifted focus from demand (labor & income), to supply (capital, credit, property).

So, what had changed? Finance capitalism had remade the parameters of the economy. Congress, Carter, Reagan, and Pratt did not fully understand this. Laws were changed in order to save the industry, but these changes remade it. Small savers, once the central aspect of S&Ls, were all but written out of the new model of capital growth for the industry as access to highly speculative sources of income—from consumer debt and global money markets—replaced local wage workers. Most importantly, the accounting rule changes—done to stabilize the industry—created financial production. Amortization, depreciation, and appreciation had long been part of the real estate market. Now it was *the* means for growth. Before, income was generated by charging interest on a loan. The home itself may grow in value, but the most important aspect for the S&L industry was tapping into a wage-earner's income and redistributing that toward property ownership, for a fee. Now, income was the property itself. Owning a property could suddenly add capital to your balance book. The future cost, or government reimbursed loss, of the property was the single most important input for S&L accountants. Property itself was the income, not an interest payment on a loan. In other words, property had become liquid capital. It is this new reality that both bore the fruit of rapid “profit” earning for the S&L industry in 1983, and caused it to implode three years later.

If we were to ever name a specific year of when magical thinking took material form in the economy, 1983 would be a top contender. The American economy grew about “4% per year from the recession year of 1982 through the cyclical peak in 1990.” There were many causes for the Reagan Recovery, not least of which was Paul Volcker’s dramatic lowering of interest rates. Between 1983 and 1985 short-term interest rates dropped from 11 percent to less than seven percent. Congruently, the gross national product rose an average of 8 percent per year.⁴⁹

Savings and loans, saved from complete annihilation, were primed to take advantage of the growing economy. In 1983, the industry recovered almost \$6 billion as a \$4.1 billion in loss in 1982 grew into \$1.9 billion in profit in the next year. Furthermore, the value of assets held by the industry rose 17% between 1983 and 1985 to a record amount of \$1.1 trillion. Deregulation and FHLBB rule changes resulted in larger thrifts with access to a diverse array of investment opportunities. In 1979, 69% of total S&L assets were traditional family mortgages. In 1985, only 44% of total S&L industry assets were held in these mortgages.⁵⁰

The three largest Sunbelt economies—Texas, California, and Florida—were leaders in the recovery. Construction and real estate had long been central to these states’ economies. Coral Gables, Florida and Los Angeles, California had all but invented the highly speculative model of residential growth that would become the hallmark feature of the postwar economy.⁵¹ However, in the early 1980s, these three states took real estate speculation to a new level. Following the precedent created in Garn-St. Germain, California passed the Nolan Bill in late 1982. This law,

⁴⁹ David Kotz, *The Rise and Fall of Neoliberal Capitalism* (Harvard University Press, 2015), 226 FN 15.

⁵⁰ *Savings and Loan Sourcebook, '86* (United States League of Savings Institutions, 1986), 46-49; Office of Thrift Supervision, *1999 Fact Book: A Statistical Profile on the United States Thrift Industry* (Office of Thrift Supervision, June 2000), 10; Robert A. Bennet, “Savings Institutions are Healthier but Now Face Further Challenges,” *New York Times*, December 30, 1982, A1, D4.

⁵¹ Mike Davis, *City of Quartz: Excavating the Future of Los Angeles* (Verso, 1990, 2006), 99-150.

quickly adapted by Florida and Texas, ended restrictions on state-chartered thrifts lending and allowed up to 100% of the S&L's deposits (their liquid capital) to be invested into any type of venture. In short, S&Ls in these three states could take the savings and mortgage payments of their customers and invest that money into anything. Not local mortgage payments. Not even just commercial property. But any investment scheme offered nationally or internationally. As a result, the S&Ls in these three Sunbelt states grew to 19% of total national industry assets (\$214 billion) between 1982 and 1985.⁵²

The rapid transition from crisis to historic profit was not only the result of changes in laws that directly governed the S&L industry. The Economic Recovery Tax Act of 1981 fundamentally transformed how real estate was viewed by investors. Recall that the 1981 tax bill completely restructured the Accelerated Cost Recovery Schedule (ACRS). Exactly mirroring the strategy behind the shift from GAAP to RAP, the ACRS created a short depreciation schedule reduced from an average of 40 years to 15, which allowed corporations to write off investments in order to receive massive tax subsidies. This massive tax cut was promoted as a crucial strategy to provide American industrial manufacturing firms the means to invest and upgrade their aging plants in order to increase capacity and efficiency, which in theory would result in a dynamic new American manufacturing base that could compete in the global marketplace. As we learned in the previous chapter, this did not work as intended.⁵³

⁵² *Hearings Before the Committee on Banking, Housing and Urban Affairs, of the United States Senate*, "Statement of Edwin J. Gray, Past Chairman Federal Home Loan Bank Board," 161; "More Bungled Deregulation," *Savings Loan News* 104 (March 1983), 6; Mason, *From Buildings and Loans to Bail-Outs*, 224; Barth, *The Great Savings and Loan Debacle*, 55-56; Ramon P. DeGennaro, Larry H. Lang, and James B. Thompson, *Troubled Savings and Loan Institutions: Voluntary Restructuring Under Insolvency*, Research Working Paper 9112 (Federal Reserve Bank of Cleveland, 1991), 9.

⁵³ The ACRS is only one of many tax loopholes in the 1981 tax bill. Another, Safe-Harbor-Leasing, allowed one company to sell their tax savings to another. For example, Ford Motor Company sold IBM the tax breaks on their entire \$1 billion 1981 investment program, for a price between \$100 million and \$200 million. When combined with the ACRS, companies could profit from their tax avoidance. Robert McIntyre, *Money for Nothing: The Failure of*

Real estate was long a key investment strategy for corporations and individuals. However, historically returns on real estate investment could take decades to mature, or even just be used as a type of insurance policy as corporate headquarters or other buildings could be sold to quickly create liquid capital. However, thanks to the ACRS, real estate became, essentially, a form of short-term capital investment. Tax cuts, resulting in massive earnings, could be realized in a matter of a few short years, or even fiscal quarters. By 1983, S&Ls were in the center of a new world of financial investment and speculation. Thrifts themselves could invest widely, and they themselves could be invested in widely.⁵⁴

By the mid-1980s, the most profitable thrifts were focusing on new lending opportunities opened by Garn-St. Germain and the Pratt Board. The profitability between the more conservative and what were termed “highflying” S&Ls was striking even in 1984. Savings and loans that held 68% of their assets in the traditional market of home loans, with an average of about 80% of deposits from local markets, grew at a rate less than 15 percent. Still profitable—even historically so for S&Ls—but nothing to write home about. Conversely, S&Ls that ventured into newly opened lending opportunities on average held just 53% of their assets in mortgages grew at an astonishing 50 percent. These S&Ls sought funds from the national marketplace, with 59% of their depositors coming from the local community.⁵⁵

It is hard to argue against a 50% growth in profit. But something else was also happening within the S&L industry, and the mortgage marketplace broadly: a fundamental shift in culture.

Real estate investment became cool, even sexy. For decades, “mortgage finance on Wall Street

Corporate Tax Incentives 1981-1984 (Citizens for Tax Justice, 1986); Eugene Steuerle, *The Tax Decade: How Taxes Came to Dominate the Public Agenda* (The Urban Institute Press, 1992), 45-51.

⁵⁴ NCFIRRE, *Origins and Causes of the S&L Debacle*, 40-1; Steuerle, *The Tax Decade*, 45-51.

⁵⁵ In 1983, *Savings and Loan News* changed its name to *Savings Institutions*. “Freed Institutions Set Sail on Varied Courses,” *Savings Institutions* 104 (July 1983), 72-76; “An Innovator Out Races Problems Via Growth and Astute Investing,” *Savings Loan News* 103 (August 1982), 48-53; Barth, *Savings and Loan Debacle*, 25; Mason, *From Buildings and Loans to Bail-Outs*, 225-226.

wasn't considered a particularly prestigious job.” Hemmed by Regulation Q, the mortgage market was small, “so salaries earned by mortgage traders were dwarfed by the earnings of traders in other departments.” Mortgage lenders “had the reputation of dealing with realtors in polyester leisure suits and white patent leather shoes. . . . To move from, say, corporate finance to mortgage securities was considered a step down.” No longer. The profitability of the mortgage market transformed the image of these lenders. As one recently minted Wall Street executive boasted, “Now mortgage finance is viewed as the exciting place to be. We are the ones doing the multimillion-dollar deals.” By 1984, mortgage lenders were making \$250,000 or more;⁵⁶ while creating millions for their firms.⁵⁷

Although the image of Gordon Gecko was still three years away, local S&L managers embraced this new ethos. Who wouldn't? Fixed-rate home mortgages, while stable, were boring. And generated low profits. Now, suddenly, local S&L lenders were taking part in a new and exciting world. They were very much like those Wall Street executives, embracing risk, making record profits, handing out cool off-white business cards. In fact, local lenders could take their importance a step further—after all, their actions had saved one of the pillars of local communities.⁵⁸

Deregulation had saved the S&L industry. Profitability returned to the Standard Federal Savings and Loan Association of Troy Michigans of the country and blessed Wall Street lenders with prestige and high incomes. However, some federal officials—including members of Congress—felt that deregulation had brought too much diversification to the industry. Local

⁵⁶ This is \$629,468 in today's dollars.

⁵⁷ “Late in 1983, Lehman Brothers Kuhn Loeb Inc. suffered a setback when Richard Isaacs, its top trader in mortgage-backed securities, resigned. According to industry sources, Mr. Isaacs left Lehman in a salary dispute after helping to generate some 50 million in trading profits.” See Eric N. Bergjan, “Rise of a National Mortgage Market,” *New York Times*, January 22, 1984, <https://www.nytimes.com/1984/01/22/business/rise-of-a-national-mortgage-market.html>.

⁵⁸ “Mutual to Stock Exchange Puts Management in a Fishbowl,” *Savings and Loan News* 104 (January 1983), 50-55; Nathaniel C. Nash, “Wall St. Rediscovered the Thrift Stocks,” *New York Times*, December 1, 1985, F10.

managers were too concerned with mirroring their Wall Street counterparts and sought profits in fields too far astray of home mortgages. These congressional officials recognized that the 150-year mission of S&Ls to use local savings to provide home financing to local communities was fading.⁵⁹

Edwin Gray, who replaced Pratt as chairman of the FHLBB, was not troubled by changing nature of the S&L industry.⁶⁰ Gray's attitude was based on the fact that he simply did not believe that the industry had changed. In November of 1983, Gray stated that Garn-St. Germain had "reaffirmed the essential role of the Nation's thrift institutions as the suppliers of mortgage credit to American families." For Gray, the "survival of the industry [was] tied inextricably to the willingness of institutions to move forward . . . to restructure portfolios, and to learn how to use most effectively the new Garn-St. Germain powers in order to be able to compete in the new financial services environment." Local savers were no longer part of the equation. The role of the S&L industry, according to Gray, was to simply provide capital for home mortgages. It did not matter so much where that money came from—the more diverse and far-reaching the better—as long as capital was available to create mortgages.⁶¹

Gray in many ways was representative of a typical Reagan appointee. He was a longtime friend, briefly the director of U.S. domestic policy, and even press secretary for the president. Furthermore, Gray was the public relations officer for the Great American First Savings Bank in San Diego where he vigorously lobbied for Garn-St. Germain, believing that it was essential for the survival of his employer. As described by professional muckraker, Martin Mayer, Gray was "supposed to be a dope and patsy who would go along with whatever the U.S. League and the

⁵⁹ Patrick I. Mahoney and Alive P. White, "The Thrift Industry in Transition," *Federal Reserve Bulletin* 71 (March 1985), 137-156.

⁶⁰ Pratt left for a high paying management job at the investment firm Morgan Stanley in 1983.

⁶¹ *Deregulation and the Federal Home Loan Bank Board*, 98th Cong., 1st sess., November 9, 1988, 2, 5.

Reagan administration wanted.”⁶² Accordingly, on Gray’s first day on the job, Treasury Secretary Don Regan called to ask “You’re going to be a team player, I take it?”⁶³ Gray’s experience working first-hand at an S&L, and his trust in President Reagan, led him to believe that regulation had strangled the industry and that deregulation was the key to future success. Gray managed to hold on to this belief for just over a year.⁶⁴

In early January of 1984, Gray had what he called his “Road to Damascus experience.”⁶⁵ Seated with two other FHLBB Board members, Gray watched a video taken by a Texas appraiser of the I-30 corridor on the outskirts of Dallas—the center of “Dannyland.” Empty, half built, and newly begun projects, characterized by concrete slabs, stretched beyond the camera’s view. This ultimate example of “see through” buildings were all financed by a single thrift, Empire Savings and Loan of Mesquite, Texas.⁶⁶ Gray later described the experience of watching the video: “I was so sickened by what I saw that I couldn’t watch it. It was so bad that I closed my eyes. I was so ashamed. . . . I don’t even like to talk about it now.”⁶⁷

Gray’s Bank Board closed Empire Savings that afternoon. A full investigation revealed a level of speculation that even Henry F. Potter from *It’s a Wonderful Life* would find abhorrent.

⁶² Martin Mayer, *The Greatest-Ever Bank Robbery: The Collapse of the Savings and Loan Industry* (Charles Scribner’s Sons, 1990), 117.

⁶³ Gray responded with a resounding “Sure.” See Stephen Pizzo, Mary Fricker, and Paul Muolo, *Inside Job: The Looting of America’s Savings and Loans* (HarperPerennial, 1989), 32.

⁶⁴ Robert G. Kaiser, “Behind the Saving of America’s Savings and Loans,” *Washington Post*, July 5, 1981; Kenneth B. Noble, “Reagan’s Friend at the Bank Board,” *New York Times*, May 29, 1983, F17; “New FHLBB Chairman Gray Outlines Goals,” *Savings Loan News* 104 (June 1983), 9; Pizzo, Fricker, Muolo, *Inside Job*, 30-40; Barth, *The Great Savings and Loan Debacle*, 129; Kitty Calavita, Henry N. Pontell, and Robert H. Tillman, *Big Money Crime: Fraud and Politics in the Savings and Loan Crisis* (Berkeley: University of California Press, 1997), 94-95. *Big Money Crime* is a key academic study of the S&L Crisis. All three authors were leading criminologists, and thus argued that the crisis itself was the product of fraud and political manipulation.

⁶⁵ William K. Black, “Why (Some) Regulators Don’t Think Regulation Works,” paper prepared for the annual meeting of the Allied Social Science Association, Boston, 3-5 January 1994, 9.

⁶⁶ Recall that “see through” buildings referred to new developments that remained unrented and empty for years. Thus, one could literally see through from window to window without obstruction from the outside.

⁶⁷ Michael Binstein, “They Were Calling Me the Gestapo: A Conversation with Ed Gray,” *Regardie’s*, Vol. 92, Iss., 2 (October 1988), 93-94; Allen Pusey, “Fast Money and Fraud,” *New York Times*, April 23, 1989, section 6, page 30.

Empire took full use of the deregulatory measures of Garn-St. Germain, using leveraged funds to invest in building condominiums where there was no demand for housing. Beyond that, Empire's loan officers engaged in a practice that would be later made famous by Charles Keating as they sold a unit of land back and forth with other associates, each time the "buyer" would pay a little more, thus making the empty land appreciate, almost by magic. This higher value was then used to justify ever increasing loans for ever more unneeded condominiums. At least Pottersville provided useful, though unsavory, storefronts and housing units. When all was said and done, the federal government filed civil and criminal charges against over one hundred companies—including Danny Faulkner's—involved with Empire Savings and Loan.⁶⁸

Subsequent investigations by Gray's Bank Board, and eventually a Congressional Oversight Committee, revealed the extent of fraud that had encompassed much of the S&L industry after 1980. For example, an ex-pilot, Ranbir Sahni bought 96% of American Diversified Savings Banks of Lodi California's stock in 1983, making him the de facto sole owner of the thrift. Taking advantage of the accelerated depreciation schedule of the 1981 Tax Reform Act, Sahni invested millions in windmill farms across the desert of southern California, shopping centers, and even a chicken farm designed to process manure into methane energy. Sahni gained millions in tax breaks from each endeavor. However, he was an investor in all the real estate deals that involved his S&L—thus creating a dynamic where Sahni embezzled government-insured funds from his S&L into properties that he owned. Each investment added a new asset to borrow against on the books of Diversified Savings, allowing Sahni to use as leverage to borrow even greater amounts against these assets for more investment capital. In three years, Sahni's actions grew the S&L's assets from \$11 million to \$792 million. By 1986, his S&L's

⁶⁸ *Zervas v. Faulkner*, 861 F.2d 823 (5th Cir. Appeals, 1988), <https://case-law.vlex.com/vid/zervas-v-faulkner-no-895603924>; NICFIRRE, *Origins and Causes of the S&L Debacle*, 56-57.

bookkeeping became ever more preposterous, registering \$893 million in deposits, with only \$22 million from actual Lodi customers. Gray's Board audited the thrift and quickly shut it down, citing "that many of the firm's loans were based on 'inadequate or inflated appraisals. Reappraisals (by FHLB-appointed appraisers) indicate there will be losses in excess of \$23 million on these loans alone.'"⁶⁹

Another favorite scheme was called trading "dead cows for dead horses." This plan centered on trading bad assets themselves, as opposed to loans. Savings & Loans across the country simply traded under- or nonperforming assets to each other in order to keep these depreciating loans off their books. This made participating S&Ls' finances look healthier to regulators and investors. Once one S&L passed a review, or received the targeted capital investment, they would take back the bad asset from the other thrift, allowing said thrift to pass their own review. The practice became so widespread that in 1985 representatives of the nineteen largest S&Ls in Texas met in Houston to coordinate a large-scale "dead cows for dead horses" scheme to keep newly energized Bank Board regulators at bay.⁷⁰

Throughout 1984 and 1985 Gray imposed stricter supervisory measures and reversed much the Pratt's deregulatory measures. Limits on the ability of S&Ls to invest in equity securities, an increase from near zero to seven percent in owner equity, and an increased minimum net worth requirement were all aimed to help curtail rampant speculation. As seen in the Diversified Savings case, audits were increased. In order to bolster the capacity of federal oversight, Gray transferred control of S&L audits from the Board to individual home loan banks.

⁶⁹ James Granelli and John O'Dell, "U.S. Regulators Seize American Diversified Savings & Loan," *Los Angeles Times*, February 15, 1986; Calavita, Pontell, and Tillman, *Big Money Crime*, 52-53.

⁷⁰ Joel Glenn Brenner, "S&L Bailout: How Delays Drove Up Cost," *Washington Post*, March 11, 1990, H1; U.S. Congress, House, House Committee on Banking, Finance, and Urban Affairs, *Effectiveness of Law Enforcement against Financial Crime*, 101st Cong., 1st sess., pt. 1, April 11, 1990, 799-880; Calavita, Pontell, and Tillman, *Big Money Crime*, 54-55.

This essentially privatized the federal oversight. Because examiners were no longer federal employees, officials could get around Reagan administration salary caps, allowing both increased staff size and salary. By 1986, examiner pay had increased by a third and the overall regulatory staff doubled.⁷¹

Gray's actions did not win him friends in Washington, D.C. Reagan's Chief of Staff (and former Treasury Secretary), Don Regan, gave Gray the nickname of "the great Reregulator," and complained that Gray was "off the reservation" and a de facto enemy of the Reagan administration.⁷² Gray soon faced attacks from the League, and even Democratic House Leader, Jim Wright, as well and other members of Congress (specifically, the Keating Five).⁷³

The hostility towards Gray after 1984 can be explained by two ideas. First and foremost, Gray's calls for reregulation and an expansion of governmental supervisory bureaucracy runs counter to the ideology of the Reagan Revolution. David Stockman flatly stated that as the Director of the Office of Management and Budget [OMB], he purposefully "didn't provide Gray with the manpower he sought," and more to the point, still rejected as late as 1988 "suggestions that the thrift crisis had anything to do with the number of 'FSLIC bureaucrats' . . . that were hired." The need for governmental supervision and regulation was antithetical to the entire premise of Reagan's free market rhetoric. True believers within his administration—in this case Stockman—implemented policy that strictly adhered to this ideology throughout Reagan's first

⁷¹ Nathaniel C. Nash, "Bank Board's Embattled Chief," *New York Times*, November 4, 1985, D1, D6; NCFIRRE, *Origins and Causes of the S&L Debacle*, 56; "Making S&Ls Pay for Living Dangerously," *Business Week*, September 9, 1985, 30-31.

⁷² Black, "Why (Some) Regulators Don't Think Regulation Works," 3-5 January 1994, 9; NCFIRRE, *Origins and Causes of the S&L Debacle*, 56-57.

⁷³ "Chief Repays F.H.L.B.B.," *New York Times*, December 3, 1986. During the height of the S&L industry's second collapse in 10 years, Gray was charged with funneling FHLBB expense money for personal trips. Gray "repaid \$13,868 for a chartered private jet and \$11,899 in expense money he received as reimbursement for trips taken by his wife." The \$13,868 was used to book a private plane to attend a regional meeting of bank board president in California. Simultaneously, Gray's father fell ill, so Gray visited him on the same trip, thus allowing the Reagan administration to charge him with an ethics violation. The \$11,899 was used on various flights that Gray's wife took for business trips. See, "Chief Repays F.H.L.B.B.," *AP / New York Times*, December 3, 1986, D2; Bill Ritter, "Gray Claims Probe Into His Expenses is Intimidation," *New York Times*, November 6, 1986, D1.

term, despite—and in fact actively ignoring—contrary evidence. Gray’s move to privatize oversight was a strategy specifically designed to “get the examiners out from under the control of the people at the OMB, some of whom seemed to be ideological crazies who couldn't seem to understand the importance of regulating to protect the FSLIC, and ultimately the taxpayers.”⁷⁴

Resistance to reregulation among Reagan’s true-believers is not surprising. However, the attacks against Gray were not limited to ideologically pure Republicans. Jim Wright (D-Tx), the House Majority leader from 1976 to 1987, and then the Speaker of the House from 1987 to 1989, vigorously opposed Gray’s attempts to reign in the S&L industry. In 1986, Wright asked Gray to replace a bank board agent who was investigating a Dallas real estate syndicator, Craig Hall. Wright claimed the agent “wasn’t being fair to Hall” and that the FHLBB Board was “too inflexible.” In another incident, Wright complained to Gray that real estate developers were “being treated very poorly by the bank board, particularly by Joe Selby in Dallas.” Again, a FHLBB was closely monitoring the finances of S&Ls in and around Dallas, and again Wright asked Gray “Isn't there anything at all you can do to get him out of the job, to let him go?” Wright went so far as to hold a key piece of legislation that would recapitalize the FSLIC in limbo until Gray bent to his demands. In response Gray remarked that Wright “didn't seem to have any concern for protecting depositors, only savings and loan operators, whom he characterized as his ‘constituents’ . . . the third most powerful man in the country was holding a bill hostage for some ‘constituents.’”⁷⁵

Wright’s actions reeked of political corruption. The stink was palpable because, well, there was political corruption. William K. Black, a former regulator for the FHLBB, spends an

⁷⁴ Binstein, “They Were Calling Me the Gestapo,” 95.

⁷⁵ Binstein, “They Were Calling Me the Gestapo,” 96. As we will see in the next section, the recapitalization bill was needed because of an escalation of S&L failures in 1985 and 1986, most of which were insured by the FSLIC—thus the government agency was going bankrupt and needed congressional approval for increased funding. Wright was investigated by an ethics committee per these charges and lost his role as Speaker of the House in 1989.

entire chapter in his investigatory book to explain in detail how Speaker Wright was recruited by real estate fraudsters, most notably Charles Keating. These “constituents” used Political Action Committees to fund election campaigns to both parties. Don Regan, stated in a 1986 letter that “[Gray’s actions] are likely to have a very adverse impact on the ability of our Party to raise needed campaign funds in the upcoming elections.”⁷⁶ The need for campaign funding is not limited to the Republican Party; thus, when Gray sought to scrutinize the financial actions of Dallas real estate moguls, Wright was asked to step in on their behalf. The standard narrative follows this path to its natural conclusion as Wright, the Keating 5, and Don Regan are all tied together as co-conspirators in the S&L industry’s fraudulent money-making scheme.⁷⁷

However, if we step back from the immediacy of these accusations, some truth to Wright’s assertions can be found. Beginning in the 1970s, oil revenues in Texas were on the upswing. By the early 1980s, Dallas and Houston were expanding at a massive rate. Construction of new houses, malls, and apartment complexes created jobs. Deregulated S&Ls across the state were central in converting oil revenue into real estate investment, which then created new jobs in the construction and service industries. Jim Wright knew this, and knew that Gray’s efforts to tamp down speculation within the S&L industry threatened the Texas economy as a whole. In short, Gray was attacking the conditions that underpinned economic growth not only in Texas, but across the country.⁷⁸

This brings us to a central question: what is economic growth in finance capitalism?

Think of Charles Keating who traded building assets between his S&L and an investment bank

⁷⁶ Black, *The Best way to Rob a Bank is to Own One*, 90.

⁷⁷ For a detailed analysis see Black, *The Best way to Rob a Bank is to Own One*, especially chapters 4 (Keating’s Unholy War against the Bank Board), 5 (The Texas Control Frauds Enlist Jim Wright), 6 (The Foustian Bargain), and 7 (The Miracles, the Massacre, and the Speakers Fall); Calavita, Pontell, and Tillman, *Big Money Crime*.

⁷⁸ Joe R. Feagin, *Free Enterprise City: Houston in Political and Economic Perspective* (Rutgers University Press, 1988), 235-36). It is important to note that Houston was having financial problems as early as 1983 due to low taxation and a slowing of the oil economy.

in order to artificially boost the price of a building, thus creating asset appreciation out of thin air to the tune of \$12 million in profits. Or, think back to Dannyland of the I-30 corridor on the outskirts of Dallas. For Gray, the images of empty apartment complexes and cracking concrete slabs gave proof to the accusation of immoral financial malfeasance. Developers were profiting off needless construction. Yes, it is fraud when two entities—Keating and the investment bank Drexel Burnham Lambert—trade properties with the sole aim to inflate the price. And yes, unnecessary development in order to profit from tax breaks is also fraud. But what is it when everyone does it? Is it fraud when an entire industry is used to develop and expand land use, thus creating said assets—and another industry develops to sell and resell said assets? What is it when a city’s economy—Dallas, Houston, Phoenix, Los Angeles—is almost entirely dependent on these transactions? Is it still fraud? Or *is the economy?*

Let’s again go back to the I-30 corridor’s plethora of empty buildings. For Gray, these buildings served no purpose. They destroyed the natural environment, wasted resources, and stood as a testament to the greed and absurdity of the 1980s. Yet, when we shift focus ever so slightly, we can find new meaning in these empty assets. The key to understanding the political economy of financial production is not to think of the asset—in this case an empty apartment building—as the end product. But rather, the wealth created in financing, constructing, and eventually servicing the building is the product. In real life, the building is empty. On an investment banker’s spreadsheet, it holds a certain value that can rise or fall. This value can be borrowed against—or invested, in hopes that the future will bring increased value. However, on the ground the empty building needed to be built. Materials were made and bought to construct the building. Labor—from semi-skilled carpenters to highly skilled electricians—were paid to complete this work. Building inspectors and government-employed planning agents make sure

the building is up to municipal code. Appraisers and assessors set the valuation of the building. Painters, gardeners, and cleaners make and maintain the presentability of the building, even if just for a short time. The money made from these services bought food, haircuts, gas, cars, and perhaps even paid off a mortgage held by a local savings and loan. This is all to say that an empty building is an empty building, but there is a network of economic exchange that surrounds the creation of what is, in the end, perhaps a useless mass of concrete, steel, and glass.

So, does it matter that the buildings remain unused? Yes and no. In the short term, the economy grows as land is developed into assets and services rise to meet the demand created by said development. On the financial side, S&Ls can use the development of assets to attract investment, and then loan that money out to develop more assets, pocket millions in fees, and then package said loans and sell them to other S&Ls or investment banks, thus continuing the process forever. All while hiring the increasing numbers of men and women in the service industry to cook their meals, clean their homes, and watch their children. As long as speculation remained untampered there would always be a future where assets are worth more and thus a sound investment, and that future provides the profits of today. Accelerated depreciation schedules, the lowered accounting requirements of RAP, and even a healthy dose of fraud and greed all work together to lubricate the wheels of the financial production machine. Political ideology and/or corruption create and reinforce the rules and opportunities that make the difference between investment and speculation hazy and unclear. But yet, jobs were created, cities expanded, and the economy grew.⁷⁹

⁷⁹ Shane Hamilton, *Trucking Country: The Road to America's Wal-Mart Economy* (Princeton University Press, 2008); Beethany Moreton, *To Serve God and Wal-Mart* (Harvard University Press, 2010); Nelson Lichtenstein, *The Retail Revolution: How Wal-Mart Created A Brave New World of Business* (Picador, 2009).

Two discrete events pulled the proverbial plug on the party. The first centered on the oil economy of the southwest generally, and Houston specifically. Beginning in the mid-1970s, Houston experienced massive economic growth. High oil prices—the same that helped lead to stagflation and deindustrialization of the Rustbelt—led to massive profitability for Houston’s refineries and petrochemical plants. Higher wages, and an escape from the snow and seemingly eternal downward spiral of job loss and growing urban poverty, attracted many working-class Americans into the city.⁸⁰ These new residents needed housing. Congruently, the historically high profits from the oil crisis created a glut of liquid capital. A near-perfect union was formed as the profits from the oil boom were used to finance Houston’s growing housing economy. Automobiles, low-density housing, and a seemingly endless amount of land created a “limitless city”—one without a central downtown, where every new housing development created a new investment opportunity, and a new chance to find the American dream of cheap housing. All made possible by the oil boom.⁸¹

Despite the best attempts of investors, every boom has a bust. In 1984, oil prices began to fall. What was seen by many Americans as a sign of success for Reagan’s economy—lower oil prices reduced the cost of almost every product in the economy, thus automatically increased the earning power of most Americans—was tragedy for Houston. Texas lost 25,000 jobs and \$100 million in revenue with each \$1 drop in the price of oil. By 1986, the price of crude oil had dropped 60 percent. One third of Houston’s office space and nearly 20% of homes and

⁸⁰ “Houston: A New Promised Land for Skilled Middle Class,” *New York Times*, February 10, 1978, A3.

⁸¹ Feagin, *Free Enterprise City*; Martin V. Melosi and Joseph A. Pratt, eds., *Energy Metropolis: An Environmental History of Houston and the Gulf Coast* (University of Pittsburgh Press, 2007); Oliver Gillham, *The Limitless City: A Primer on the Urban Sprawl Debate* (Island Press, 2002); Peter G. Rowe, Barrie Scardino, and William F. Stern, ed., *Ephemeral City: Cite Looks at Houston* (University of Texas Press, 2003).

apartments were vacant. With this sudden glut of inventory, real estate investment evaporated. Once profitable savings and loans throughout the state were suddenly losing millions.⁸²

Although Houston's phenomenal growth during a period marked by shuttered factories and seemingly unending inflation was promoted as another example of the magical marketplace, it was not. Rather, it was yet another commodity bubble—if you replace corn for oil, one very much like the one that Midwestern farmers experienced in the same period. And again, like all commodity bubbles, the bust was shaped by events beyond the control of local investors. The similarities do not stop there, for much like the Farm Crisis, the final back-breaking straw was caused by the federal government. In 1980, it was Carter's decision to end grain sales to the Soviets. In 1986, it was congressional action to reign in real estate speculation. However, unlike the Farm Crisis, the Tax Reform Act of 1986 caused a national, not regional, crisis within the S&L industry.

The effect of the ACRS on the domestic housing market was not discussed in congressional hearings for the 1986 Tax Reform Act. Instead, the debate focused on the fact that the ACRS effectively used taxpayers to subsidize corporate efforts towards deindustrialization. However, the effect of TRA86 on the domestic real estate market was immediate. After growing from \$3.2 billion to \$16 billion between 1981 and 1985, total real estate sales tanked; by 1989 the market was attracting just \$1.5 billion in new investment capital. Residential construction, now without access to easy financing, sank. The Sunbelt states of Texas, Arizona, and California—once recognized as the antithesis of the Rustbelt malaise—were hardest hit. Again, unintended consequences reshaped and remade the economy. The industrial manufacturing of the northeast was replaced by residential construction in the Sunbelt. Although the base of employment and economic growth had changed, the centrality of finance—and the need for

⁸² FDIC, *Managing the Crisis*, 795, 798, 808; NCFIRRE, *Origins and Causes of the S&L Debacle*, 60-61.

investment—merely shifted focus. Once investment dried up, the magic of the marketplace could not help the new site of the American Dream.⁸³

The combined effects of the oil crash and TRA86 effectively ended access to easy capital. In 1986, losses of 27% of the S&L industry equaled the profits of the remaining 73% (meaning that the losses of under one-third of the industry losses were huge, as the gains of the remaining three-quarters were small). Two-hundred and fifty-five thrifts with \$68 billion in assets were RAP-insolvent, up from 71 in 1984 (remember, RAP was far more generous in how S&Ls are allowed to report equity, assets, income, and expenses than the previous industry standard of GAAP—under older rules the industry was in far worse shape). By 1987 the share of S&Ls losing money was up to 35%, with \$14.4 billion in losses compared to \$6.6 billion in income of profitable S&Ls.⁸⁴

The second crisis to hit the S&L industry in under a decade was met with what can best be described as a disordered federal response. This was not due to a lack of plans nor strategy—in fact many were implemented. Rather, politics more than problem-solving framed how the White House and Congress acted. By 1986, federal regulators realized the severity of the S&L implosion. The massive losses listed by a growing number of thrifts quickly outpaced the reserves of the FSLIC—the government entity in charge of insuring the S&L industry. The White House sent Congress a plan in April of that year to recapitalize the FSLIC to the tune of \$15 billion (losses did not reach \$14 billion until 1987, thus this plan would have covered the entirety of the failing firms in 1986).⁸⁵

However, Congress split on the plan. Some members stymied the request because they wanted a formal investigation into thrift abuses. Another cohort, composed almost entirely of

⁸³ FDIC, *History of the Eighties*, 303-5; Barth, *The Great Savings and Loan Debacle*, 45.

⁸⁴ FDIC, *Managing the Crisis*, 795, 798, 808.

⁸⁵ NICFIRRE, *Origins and Causes of the S&L Debacle*, 57-59.

Republicans, rejected the plan because it did not comply with the Gramm-Rudman-Hollings anti-deficit law. The White House would have to find areas to cut funding in order to offset the \$15 billion. The League itself maintained that there was no crisis, insisting that Gray's Board was overstating the industry's financial instability. Even the White House failed to fully press the plan because the entire debacle reflected poorly on Reagan's rhetoric on market efficiency.⁸⁶

The issue remained unresolved well into summer of the next year. In the meantime, S&Ls continued to fail, causing further strain on the FSLIC. By the time Congress passed the Competitive Equality Banking Act (CEBA)—designed to recapitalize the FSLIC for \$10.8 billion—the FSLIC was in fact bankrupt, with a negative net worth of \$6.3 billion. CEBA was too little, too late as 11% of the industry—holding \$99 billion in assets—were RAP insolvent. Something far greater than previously imagined had to be done to save the S&L industry.⁸⁷

The "Southwest Plan" was introduced in 1988. Led by the new Bank Board Chair, M. Danny Wall (who replaced Gray in 1987), the Southwest Plan's goal was to sell failing thrifts to new investors. This would consolidate S&Ls into larger operations, thus mitigating losses with higher access to capital. The plan was yet another in a series of high stakes mergers that became the hallmark of 1980s business practice. In order to attract investors, the federal government subsidized the cost of investment through tax breaks. For example, Ronald Perlman, a leading financier, invested \$315 million to acquire five failing thrifts. In return he received \$897 million in tax deductions (a net gain of \$582 million of tax-payer funded profits). Yet, the crisis

⁸⁶ *Savings Institutions Sourcebook*, '89 (United States League, 1989); NICFIRRE, *Origins and Causes of the S&L Debacle*, 57-59; Nathaniel C. Nash, "400 Thrift Units Called Effectively Unsound," *New York Times*, June 3, 1985, D1, D14; "It's Touch-and-Go for Troubled Thrifts," *US New and World Report*, March 4, 1985, 92; "Washington Wrangles as Thrift Crisis Deepens," *Business Week*, May 27, 1985, 127-30; Richard L. Berke, "Officials Say House Speaker Intervened in Texan's Case," *New York Times*, June 22, 1987, 17; Nathaniel C. Nash, "Savings-Loan Units Flex Their Lobbying Muscles," *New York Times*, June 26, 1987, 4.

⁸⁷ "Washington Wrangles as Thrift Crisis Deepens," 127-30.

continued through 1988 as nearly 250 S&Ls, worth nearly \$81 billion in assets, were RAP-insolvent by year's end.⁸⁸

The Southwest Plan was in essence a private/public bail out for the S&L industry. Again, instead of letting the magic of the market punish those who had over-leveraged in order to invest in absurd schemes, the federal government stepped in to try to save the industry. In the end, the Bank Board spent \$32.6 billion—again, of taxpayer money—over the next decade to insure losses of acquired S&Ls.⁸⁹

Now it is time for the last magic trick of finance capitalism. The money spent by the federal government was understood as staggering, estimated at \$145 billion of taxpayer funds used, but perhaps “closer to \$400 billion if you count 30 years of interest on the money borrowed to finance the cleanup.” However, what was bought—failing S&Ls' mortgages—were investments. As the economy recovered in the mid-1990s, these mortgages began to appreciate. In the end, the federal government “sold off more than \$465 billion in assets, including 120,000 real estate properties,” thus made back the initial bail-out investment, plus a decent percentage in profits.⁹⁰

I have just listed numbers detailing the cost of the S&L Crisis and then promptly told you that it does not matter because, in the end, the government made money. This is confusing. But it also gets the heart of financialized production. As long as the federal government is willing to

⁸⁸ Thomas C. Hayes, “13 More Savings Bail-outs Set,” *New York Times*, December 30, 1988, D1, D12; Nathaniel C. Nash, “U.S. Bank Board Adds More Ailing Savings and Loans to Its Pile of Bail-outs,” *New York Times*, January 1, 1989, sec. 1, 16; Nathaniel C. Nash, “Financiers Sense an Opportunity in the Savings Industry's Distress,” *New York Times*, January 1, 1989, sec. 1, 16.; National Commission on Financial Institution Reform, Recovery, and Enforcement, *Origins and Causes of the S&L Debacle: A Blueprint for Reform: A Report to the President and Congress of the United States*, Washington, DC: The Commission, 1993; FDIC, *History of the Eighties*, 186

⁸⁹ NCFIRRE, *Origins and Causes of the S&L Debacle*, 60.

⁹⁰ Kirstin Downey Grimsley, “After Closing Many Doors, RTC Shuts Its Own,” *Washington Post*, December 29, 1995, <https://www.washingtonpost.com/archive/business/1995/12/29/after-closing-many-doors-rtc-shuts-its-own/76655bc6-199b-4395-9e18-04a430aa52f1/>.

ensure investment, confidence will remain, and the market will respond. Assets will appreciate. At least, that has been the story so far.

This money could have been better spent. Instead of unneeded tracks of suburban condos, investment could have been directed into the crumbling urban cores of American cities. These areas, still reeling from the effects of redlining and policies of urban renewal, were (and still are) in desperate need of funding. Basic investment in poor communities across the nation could have resulted in not only countering generations of racist policies, but also, speaking in strict economic terms that any Reaganite would appreciate, paid enormous dividends as housing could have been used to generate economic growth and stability to millions of Americans who had been left out of the Postwar suburban growth paradigm. Instead, when the free market took over the S&L industry, it became yet another vessel for speculation. The core mission of savings and loans—to provide affordable loans to Americans so that they can achieve home ownership and wealth—was subverted. What could have been an opportunity to fund a remaking of American cities, and righting past wrongs, became just another commodity bubble.

This brings me to my final point. After the crisis, home mortgages (for those who could qualify for them) continued to be recognized as the most secure appreciable asset on the market. Home ownership remained the way to make wage workers property owners. As one federal regulator stated: “Residential mortgages do have one important virtue as an asset. They are particularly well secured in an environment of rapidly rising property values.” In order to secure rising values, the government must secure confidence. In order to secure confidence, the government must protect the producers of wealth—financiers.⁹¹

⁹¹ Carron, *The Plight of the Thrift Institutions*, 21. As discussed earlier, this mantra remained true through 2003, see, George W. Bush, “Remarks on Signing the American Dream Downpayment Act.”

The Savings and Loan Crisis of 1986 is mostly remembered as an example of the greed and white-collar lawlessness of the 1980s. Recollections of Danny Faulkner, Charles Keating, and the various investment banks such as Drexel Burnham Lambert, have come to dominate the historical imagination of the era. The S&L Crisis, however, marks a fundamental transition. Real estate, once the cornerstone of the stability imagined by the Postwar American society transformed into a type of liquid asset that bred speculation. This transformation underlines not only American economic growth, but also how everyday Americans directly connect to financialized production.

Two decades later, real estate's role in financial production would reach its zenith with the housing boom and corresponding crisis. George W. Bush's vision of an "ownership society" spurred easy access to mortgages, inflating the American real estate market. For a brief time, speculation through investment and credit allowed average Americans direct access to financial production. The home became more than a building—it became the primary means for wealth generation in the economy, allowing Americans to become financialized producers. In theory, their asset—the home—grew in value over time. This not only increased the personal wealth of the average American investor, but also their neighborhoods, community, and the nation. The act of speculating through real estate, then, became a form of financial virtuous production.⁹²

Of course, this new dynamic is worthy of an entire study. What is fundamental to consider here is that, paralleling the crises that lead to the Tax Reform Act of 1986, another pillar of mid-twentieth century American society was fundamentally transformed by the Volcker

⁹² George W. Bush, "Remarks on Signing the American Dream Downpayment Act"; Martin Wolf, *The Shifts and the Shocks: What We've Learned—And Have Still to Learn—from the Financial Crisis* (Penguin Press, 2014); John Cassidy, *Dot.con: How America Lost Its Mind and Money in the Internet Era* (HarperCollins, 2002); Adam Tooze, *Crashed: How a Decade of Financial Crises Changed the World* (Viking, 2018). Economic Growth, Regulatory Relief and Consumer Protection Act (Pub.L. 115–174, S. 2155) 2018; "Dodd-Frank Rollback 'Completely Ignores' How Financial System Works, Author Says," *Here and Now* NPR, May 23, 2018, <https://wamu.org/story/18/05/23/dodd-frank-rollback-completely-ignores-how-financial-system-works-author-says/>.

Shock, congressional action, and the resulting political economy of financial production. This fracture did more than alter the shape of what came before. It created new paths of production, growth, and prosperity. From the chaos of crises that engulfed the 1980s emerged a new ideal of virtue—people who could look into the future and capture imagined possibilities for the benefit of the American people. In order to fully understand the new world of financial production, we must turn to the city that best represented the power of the old industrial model—Chicago.

Chapter 4 Producing a Financial Future

“The time was 1970. The place was planet earth. Although few knew it at that precise moment, the world was about to enter the most volatile financial period ever to be recorded in its history.”¹ Leo Melamed, the head of the Chicago Mercantile Exchange, often spoke with a propensity for the dramatic. However, he was not far from the truth. In the early 1970s, “Price swings for commodities, oil and metals were about to enter a phase of unprecedented velocity, interest rates were about to begin a climb destined to bring record highs and inflation was about to ascend to levels which would threaten the very foundations of the western world.”²

As we have already learned, the economic chaos of stagflation was quelled by the Volcker Shock, ushering in a new economic era for the American economy. Furthermore, as explored in the previous chapters, this new era upended old understandings of the political economy in everything from taxation to how real estate operates. Although confusion about how the financialized economy worked was all too common among many decision makers across the political and economic spectrum, there were people who understood it.

According to Melamed, members of the “Chicago Mercantile Exchange ... [were] particularly well-suited and geared for upheaval, pestilence, famine and strife” In fact, “the new era seemed made to order” for the financial traders of Chicago. Financialization brought new opportunity to those who knew where to look. Harkening back to what can be labeled the gendered Ur creation myth of the nation, Melamed fervently claimed that “futures trading of

¹ Leo Melamed, “Welcoming Remarks,” Options and futures Strategies for Portfolio Managers Conference, Coronado, Ca, February 16, 1987, University of Illinois Chicago Special Collections (Richard J. Daley Library), Chicago Mercantile Exchange records [hereinafter CME], Series 2, Box 66, Folder 2.

² Leo Melamed, “Welcoming Remarks,” Options and futures Strategies for Portfolio Managers Conference, Coronado, Ca, February 16, 1987, CME Series 2, Box 66, Folder 2.

commodities represent . . . perhaps one of the last adventuresome frontiers on our terra firma. A frontier where the frontiersman still must rely solely on his own ingenuity and common sense.” Financialization wrought a new world. “This frontier still is available to a multitude of Americans who have the heart and spirit and desire to learn what it takes.” Primarily for Melamed, the financial economy was destined to be an American success story as “Commodity futures are as inherently an American institution as the free enterprise system itself.”³

These financial frontiersmen would ultimately shape the economic wilderness of the 1970s and 1980s. This chapter steps back from Reagan’s second term in order to analyze how the seeds of the financialized economy, the Reagan Recovery, and Crash of 1987 were planted throughout the 1970s. Financialization began long before Reagan entered the White House, further reinforcing that many economic changes were beyond Reagan’s direct control. In fact, legislative changes, instigated by financial traders like Leo Melamed and capped by the passage of the *Futures Trading Act of 1982*, ran continuously through the 1970s, no matter who occupied the White House.

By 1982, Bretton Woods was replaced with the market dynamics of a system that thrived in speculation and imagination. Chicago’s futures exchanges, long-time experts in agricultural commodities, successfully created a new wealth-generating regime, saving the city from the Rustbelt malaise of so many other midwestern cities, making Chicago central to the developing financialized economy. Just as the S&Ls of the Sunbelt funneled oil revenues into real estate, the Exchanges’ expertise in risk management, liquidity, and adaptation suddenly made what was old very new. The promise to stabilize chaotic international markets, bringing some sense of order to

³ Leo Melamed, “‘A Professional’s View of Commodity Trading’ A Compendium of the Remarks of Leo Melamed, Chairman of the C.M.E. Board, 1969-70-71, and the I.M.M Board 1972-73,” Before the Financial Editors Seminars of Nov 10 1969 and Nov 28, 1972, CME Series 2, Box 66, Folder 2.

the world economy, and above all else, acquiring ever-increasing profits, allowed these financial investors to take up the mantle of virtuous producers.

In the 1970s, the newly elected head of the Chicago Mercantile Exchange, Leo Melamed, began to transform how futures exchanges operated. Moving beyond agriculture, Melamed created new products that focused on financial instruments. Other futures markets followed Melamed's lead. Soon futures in currency, the S&P 500, and of course, mortgages, became a booming industry. Just as deindustrialization expanded across the country, its replacement, the financial industry, expanded.⁴

These new products transformed the marketplace. The distance between the material world of actual goods and the imagined world of future goods almost completely dissolved. Commodities that you had to truck, carry, or barter, such as wheat, were transformed into bundled derivatives that speculated on the future value of Wall Street itself. Congress, recognizing the need to support the source of this new wealth creation, remade laws. Century-old jurisprudence regulating the futures industry was upended. Ideas centering on “contemplating delivery” were cast away for “cash settlement.”

The pioneering financiers' new products not only upended years of jurisprudence regarding how the futures industry worked, they also called into the question of what, exactly, is a commodity. Specifically, could something that was recognized as a security—mortgages—suddenly become a commodity if they were traded in the futures market? What agency had regulatory rights over such a transaction? One that centered on securities, or one that focused on

⁴ Greta R. Krippner, *Capitalizing on Crisis: The Political Origins of the Rise of Finance* (Harvard University Press, 2011); Louis Hyman, *Debtor Nation: The History of America in Red Ink* (Princeton University Press, 2011).

commodities? Furthermore, were these new products merely gambling, with speculative values only derived from the minds of scheming traders?

In early 1982, Congress set out to resolve these questions. The passage of the Futures Trading Act of 1982 codified the new economic paradigm of financialized production. Citing price discovery and facilitating liquidity as economically necessary, Congress made the imagined future of financial traders real. Although the debate surrounding the passage was often confused as to the long-term effects of financialized futures on the economy, a key aspect of the newly forming neoliberal political economy was illuminated: the continued centrality of the federal government in the marketplace. While men like Leo Melamed could create wealth seemingly out of thin air by speculating on an unknown future, these claims are only made possible when they, as contracts, were backed by legal instruments of the state. As the virtue of wealth creation began to be ascribed to the traders of the Chicago Mercantile Exchange, Congress followed suit, codifying their newly-created schemes into law. Congress had, and continues to hold, the power to support or destroy new financial strategies. After 1982, Congress continued to support financiers pioneering financial products as they were recognized as necessary, and even virtuous, producers of the rapidly transforming economy.

Leo Melamed was rarely content. Born in Poland in 1932, his family fled the Nazis when he was seven, traveling across the world before ending up in Chicago. Following an almost fairy-tale American immigrant plot line, Melamed excelled in school, attending the University of Illinois and then John Marshall Law school in his adopted home town. In order to help pay for law school, Melamed began trading futures at the Chicago Mercantile Exchange (CME). “[T]he love affair was instantaneous and serious.” From the moment Melamed saw the “bronze

chicken” statue “and opened the glass doors to the Merc trading floor [he] could never quite get it out of [his] blood.” He was enamored by the culture. Loud suits, sports cars, cigarettes, and futures trading were his life, soon becoming the youngest board member of the Exchange.⁵

Yet, Melamed wanted more. Driven by “new ideas, new commodities, new blood, new rules” he began to look for ways to increase trading at the CME.⁶ In 1970, the CME was a scrappy, second-tier institution on the Chicago futures market. The Chicago Board of Trade (CBOT), dating back to 1845, was the center of the futures world. Wheat had made it powerful, and its monopoly on grain futures continued to pay dividends as President Nixon prompted his Secretary of Agriculture to improve farmers’ income to secure their vote in the 1972 election.⁷ Although this eventually led to the Farm Crisis discussed in chapter one, futures in wheat had become a hot commodity; a commodity that the CME could not trade. Instead, the CME was relegated to the margins of the futures market, with pork bellies being their only big money maker. To expand the CME’s fortunes, Melamed implemented futures on shrimp, apples, and turkeys, which were a bust; and cattle, hogs, and lumber, which did well. But not well enough.⁸

By 1970, Melamed was certain of one thing: “agriculture was never going to be the future. But finance was.”⁹ This was a novel idea. After all, as Melamed knew, the futures

⁵ Leo Melamed, “Thank You” Speech Presented at the Chicago Mercantile Exchange, Tribute to Leo Melamed January 26, 1991, [p.1], CME Series 2 Box 67, Folder 3.

⁶ Leo Melamed, “Forward Motion,” Speech Presented at the Semi-Annual Members’ Meeting, Bismarck Hotel, Chicago IL July 16, 1969 [p.1], CME Series 2 Box 66, Folder 1.

⁷ Senate Committee on Agriculture and Forestry, *Nomination of Earl Lauer Butz*, 92nd Cong., 1st sess., Executive Report No. 92-13, November 23, 1971; Robert Mason, *Richard Nixon and the Quest for a New Majority* (Chapel Hill: University of North Carolina Press, 2004), 192-234. This is the catalyst for the Farm Crisis of the 1980s as discussed in Chapter 1.

⁸ Leo Melamed, “Forward Motion,” Speech Presented at the Semi-Annual Members’ Meeting, Bismarck Hotel, Chicago IL July 16, 1969, CME Series 2, Box 66, Folder 1; Leo Melamed, “The Technical Approach to Commodity Trading,” Speech Presented at the “How to Invest” Seminar in New York City, April 1970, CME Series 2, Box 66, Folder 1; “1972 Chicago Mercantile Exchange Annual Report,” Chicago Mercantile Exchange, 1973, CME Series 1, Box 1, Folder 9.

⁹ Leo Melamed and Bob Tamarkin, *Escape to the Futures* (John Wiley & Sons, 1996), 242; Leo Melamed, “A Futures Market in Currency,” Speech Presented to the New York Society of Security Analysts, New York, NY, April 19, 1972, CME Series 2, Box 66, Folder 2.

markets “since time immemorial, were the unique and exclusive domain of agriculture.”¹⁰

Futures have an aura of being incomprehensible. However, they are simply contracts between a willing buyer and seller for an item, at an agreed upon price and on a specific future date.

Historically, as Melamed stated, futures contracts were centered on agricultural commodities.

This is an important point to note—historically, a commodity is a raw material, usually an agricultural product, that can be bought and sold. After dispossession and settlement by westward moving colonizers, the American wheat belt began to produce a seemingly never-ending supply of the commodity. The abundance of wheat ended the notion that the country would ever face a shortage. Thus, you could safely speculate that a bushel of wheat would be bought and sold at the marketplace next year, or the year after, and so on. In the last decades of the nineteenth century, professional traders based in Chicago began to buy and sell contracts on wheat that had not been planted.¹¹

These traders did not produce, nor even have legal title over the goods they traded. Melamed was not a pig farmer although he traded in pork belly futures. However, they played a key role in global capitalism through a process named “price discovery.” By the end of the nineteenth century, the American wheat belt produced enough wheat for domestic and international markets, making the grain a globally traded commodity. As such, wheat grown in other parts of the world would have to compete with the price of American wheat. Chicago’s exchanges became the dominate marketplace for trading wheat futures, acting as a single market for a global commodity. Thus, the agreed upon price—the futures contract—between buyers and sellers in Chicago set the world price for wheat. Their negotiations “discovered” the price of

¹⁰ Leo Melamed, “The Future of Futures” Speech Presented to The New School for Social Research New York, NY October 28, 1983, [p.2], CME Series 2 Box 66, Folder 4.

¹¹ William Cronon, *Nature’s Metropolis: Chicago and the Great West* (WW Norton, 1991), Chapter 3 “Pricing the Future: Grain,” 97-147; Jonathan Levy, *Freaks of Fortune: The Emerging World of Capitalism and Risk in America* (Harvard University Press, 2012), Chapter 7, “Trading the Future,” 231-63.

wheat, continuously throughout the trading day. Floods, droughts, and wars all affected the supply and demand of wheat. These traders—speculators of the American Midwest’s productive output—took these real-world events into consideration and applied them to the imagined future cost of wheat, thus making the future contemporaneous in the form of price.

Besides setting the world price of wheat, Chicago’s futures exchanges played a key role of risk management for producers and sellers. A farmer, or more accurately, a wheat distributor, would buy and sell futures contracts in order to hedge against a loss. Profit made in the differential between the price of the contract and that day’s market price would cover, or at least alleviate, any loss they had when selling actual bushels of wheat. Of course, futures traders in Chicago did not need to alleviate any sunk cost of an actual wheat crop. Yet, they provided needed liquidity to the exchange, and profited from the same system that provided insurance against the risk that farmers and distributors carried by supplying the world with a staple product.¹²

By the early 1970s, Melamed wondered why finance had not been considered on the futures exchanges. Melamed thought, “all my instincts told me that the world of finance could be better applied to futures markets than to the world of agriculture.”¹³ The more Melamed investigated, the more he was convinced of the new market. After all, what is the difference between speculating the future price of wheat and some financial instrument? There was no law forbidding it—in fact the only law forbidding a trade in futures pertained to onions.¹⁴ What

¹² Levy, *Freaks of Fortune*, 231-32, 235-39.

¹³ Melamed & Tamarin, *Escape to the Futures*, 171.

¹⁴ In 1959 Futures traders ““tried to corner the market. There was a bad winter and a . . . 50 pound bag of onions got down to ten cents a bag. That kind of made the growers angry. Then Congress banned them at the suggestion of the farmers.” See Tom Peak Interview Sept 19, 1989 by Joan Daley [p.18], CME Series 1, Box 5, Folder 3; Jeanne Rickey Interview by Joan Daley September 21, 1989 [p.14], CME Series 1, Bos 5, Folder 8.

Melamed needed was a chance to put his ideas to use. As luck would have it, that opportunity soon emerged in an unexpected market: foreign currency.¹⁵

Since the end of World War II, the Bretton Woods Accord established rules of international finance. Western Europe, Canada, Australia, and Japan all adopted monetary policy that maintained external exchange rates at 1 percent by tying their rates to the U.S. dollar, which in turn was tied to the price of gold at \$35 an ounce. This system successfully brought stability to international finance, preventing competitive devaluation of currencies. However, by the late 1960s, Bretton Woods began to break down. Inflation began to degrade the value of the dollar. Foreign countries, notably France, began to exchange their dollars for gold, causing the U.S. stockpile to decrease. As with most postwar paradigms, Bretton Woods was all but dead by 1970s.¹⁶

Melamed realized that “if Bretton Woods were to fall apart, then a currency futures market would work.”¹⁷ The demise of Bretton Woods gave Melamed his financial marketplace. Because countries were no longer tied to the 1 percent fluctuation rule, their relative currencies could “float.” That is, the value of one currency, say the deutschemark, could go up or down in value as compared to the dollar. No longer bound to treaties, the future price of foreign currencies was unknown. A speculator could, therefore, buy a future on the exchange value of a currency. If they believed the deutschemark would outperform the dollar, then they would exchange dollars for the German currency at one price, wait for the value to increase, and

¹⁵ Melamed, “Forward Motion,” Speech Presented at the Semi-Annual Members’ Meeting, Bismarck Hotel, Chicago IL July 16, 1969, CME Series 2 Box 66, Folder 1; Leo Melamed, “A Futures Market in Currency,” Speech Presented to the New York Society of Security Analysts, New York, NY April 19, 1972, CME Series 2, Box 66, Folder 2.

¹⁶ Judith Stein, *Pivotal Decade: How the United States Traded Factories for Finance in the Seventies* (Yale University Press, 2010); Leo Melamed, “The International Monetary Market of the Chicago Mercantile Exchange,” Speech Presented to the CME, November 27, 1974, [p.2], CME Series 2, Box 66, Folder 2.

¹⁷ Melamed & Tamarkin, *Escape to the Futures*, 173; Leo Melamed, “The Futures Market in Foreign Exchange (Meeting a New World Need),” Speech Presented at the University of Chicago Law School, Chicago, IL, November 27, 1974, CME Series 2, Box 66, Folder 2.

exchange back, at a profit. This all would be made easy if said speculators could readily find others to trade with. Say, on a trading floor that already had experience in global commodity futures.¹⁸

Melamed seized his moment. “The Chicago Mercantile Exchange saw what was coming and we saw an opportunity. But, even more than that, we saw the necessity.”¹⁹ In 1971, Melamed reached out to his “economic demigod,” Milton Friedman, who was conveniently teaching just down the road at the University of Chicago.²⁰ Friedman had already stated his desire to end Bretton Woods, arguing that traders were better suited to bring stability to exchange rates than treaties.²¹ After meeting with Melamed, and receiving a check for \$5,000 (about \$32,900 today), Friedman agreed to write an article for the Chicago Mercantile Exchange to be released to the *New York Times*, entitled “The Need for Futures Markets in Currencies.” The article went to print in December 1971, four months after Nixon announced that the United States would no longer pledge to exchange gold for foreign-held dollars. The article “brought credibility . . . strength and meaning” to Melamed’s novel idea.²²

The financial futures market was born with the creation of the International Money Market (IMM) at the CME. Melamed was not humble about the implications of this new market. “It was such a grandiose concept for our little corner of the world. Our history was butter and eggs, potatoes and onions, pork bellies and cattle. . . . A futures market in currency was a

¹⁸ Leo Melamed, “A Futures Market in Currency,” Speech Presented to the New York Society of Security Analysts, New York, NY, April 19, 1972, CME Series 2, Box 66, Folder 2.

¹⁹ Leo Melamed, “The International Monetary Market of the Chicago Mercantile Exchange,” Speech Presented at the University of Chicago Law School, Chicago IL, November 27, 1974, CME Series 2, Box 66, Folder 2.

²⁰ Melamed, “Thank You” Speech Presented at the Chicago Mercantile Exchange, Tribute to Leo Melamed January 26, 1991, [p.3, 5], CME Series 2 Box 67, Folder 3; Lennart Palme Interview by Joan Daley, Nov. 8, 1989, CME Series 1, Box 5, Folder 7.

²¹ Milton Friedman, “The Need for Futures Markets in Currencies” (December 20, 1971). *Cato Journal*, Vol. 31, No. 3, 2011, available at <https://ssrn.com/abstract=2251345>.

²² Melamed, “Thank You” Speech Presented at the Chicago Mercantile Exchange, Tribute to Leo Melamed January 26, 1991, [p.5], CME Series 2 Box 67, Folder 3; Friedman, *The Need for Futures Markets in Currencies*, 635-41.

revolutionary idea as the futures market themselves.”²³ The other members of the CME were somewhat dubious; after all, agricultural commodities had been central to the Chicago futures market for a century, no need to suddenly change the marketplace.²⁴ However, Melamed’s insistence that “the futures market have entered a new era of expansion . . . which can prove as potent, if not more potent, than was the agricultural field 100 years ago”²⁵ and the fact that “both the Treasury Department and the Federal Reserve Board had no rules on such matters,” convinced other members.²⁶

Traders had replaced treaties, at least as far as currency exchanges. But what did this mean? For Milton Friedman, it was a signal of progress. According to Friedman, the Bretton Woods system was destined to fail for numerous reasons, but perhaps mostly because the value of currency “became a matter of prestige and political controversy.” Countries would “hold on to parity for as long as they could”—resisting the need to devalue their currency—not because of market fundamentals, but because of the politics of perception. Thus, “minor problems [would] grow into major crises.” On the other hand, “speculators were the ones who were telling the truth about currency values.” They were not motivated by political gain. In fact, according to Leo Melamed, “the motivation of these people was not always personal gain, and often not gain at all. Rather, they were often motivated on behalf of the best interests of their companies, banks, nations. . . . rather than seeking a profit, they were acting to prevent or minimize a loss.” As

²³ Melamed & Tamarkin, *Escape to the Futures*, 174

²⁴ William Henner Oral History by Joan Daley, July 11, 1995, [p.28], CME Series 1, Box 5, Folder 1.

²⁵ Leo Melamed, “The Outlook of the Exchanges,” Speech Remarks by Leo Melamed Chairman of the Board Chicago Mercantile Exchange Before the Sixth International Commodities Conference, Chicago, IL Dec 7, 1976, [p.1], CME Series 2, Box 66, Folder 3.

²⁶ Melamed & Tamarkin, *Escape to the Futures*, 183; Leo Melamed, “The International Monetary Market,” Speech Presented at the International Monetary and Trade Conference, The Continental Plaza, Chicago, IL November 27, 1973, CME Series 2, Box 66, Folder 2.

opposed to “the government or central banker that had political motivations for ignoring reality Only the free forces of the marketplace can make an honest evaluation.”²⁷

In short, the financial futures trader brought virtue to the marketplace. For Friedman, Melamed, and other members of the financial community, the failure of Bretton Woods proved that “the speculator’s place in a futures market is mandatory. It is he who is willing to accept and offset the risk of the commercial user. It is he who can provide the necessary liquidity without which the commercial use cannot operate.”²⁸ Melamed viewed the traders at the CME as especially virtuous. Unlike New York or even CBOT traders, members of CME had “less formal training” and were “from humble backgrounds.” They were hardworking Midwesterners with “a common-denominator: ambition.”²⁹ The CME, unlike the international Monetary Fund or World Bank was democratic: “The traders were the shareholders, and each had a vote that counted.”³⁰ Each was focused not on personal gain, but on a common good as “the Exchange ranked higher than any single member.”³¹ The free market, executed by men and women with, “intelligence, fortitude, character and adventuresome spirit” would bring order, virtue, and democratic values back to international markets.³²

Now, all of this must be taken with a rather large grain of salt. Melamed was touting the qualities of an institution that he led, and, much like proud parents, his writings lead to hyperbole. However, they do tap into the shifting political economy of the time. Bretton Woods

²⁷ Friedman, *The Need for Futures Markets in Currencies*, 636-40; Melamed & Tamarkin, *Escape to the Futures*, 187.

²⁸ Melamed, “A Futures Market in Currency,” Speech Presented to the New York Society of Security Analysts, New York, NY, April 19, 1972, [p.1], CME Series 2, Box 66, Folder 2.

²⁹ Melamed & Tamarkin, *Escape to the Futures*, 188.

³⁰ Melamed & Tamarkin, *Escape to the Futures*, 299.

³¹ Melamed & Tamarkin, *Escape to the Futures*, 299.

³² Leo Melamed, “A Professional’s View of Commodity Trading: A Compendium of the Remarks of Leo Melamed, Chairman of the C.M.E. Board, 1969-70-71, and the I.M.M Board 1972-73 Before the Financial Editors Seminars of Nov 10 1969 and Nov 28,” CME Series 2, Box 66, Folder 2.

was one of many means of control that fell apart in the 1970s.³³ Americans, even financial advisors, were looking for answers. The free market, especially after the election of Reagan, eventually became not an answer, but THE answer to the malaise of the era.

But rhetoric alone does not qualify the impact of the new markets in financial futures. After all, the key aspect for virtuous producers was the fact that they provided for the general welfare. Chicago was once the “Hog Butcher for the World” and the “Stacker of wheat.”³⁴ By the 1970s, “The Stockyards [were] gone. But [there was] still trade in cattle future. We no longer store grain in Chicago. But still trade grain futures.”³⁵ Although the industries that built Chicago were gone, the financial sector remained. Melamed pressed this point to local politicians, media, and anyone who would listen. “A city lives or dies, prospers or fails, as a result of both accident and design—but particularly as a result of what its inhabitants do with what they have.”³⁶ Unlike other Midwestern cities where “once vital industries rested upon their past accomplishments and fossilized” Melamed’s financial futures at the CME gave Chicago a renewed economic life.³⁷ When the International Monetary Market opened in 1972, “there wasn’t one foreign bank represented in Chicago; twenty years later, there were over a hundred foreign banks operating in the city.” The success of the CME became clear “as the futures markets expanded, the Chicago politicians recognized their importance to the city—in jobs, taxes, overnight banking deposits,

³³Jonathan Levy, *Ages of American Capitalism: A History of The United States* (Random House, 2021), Chapter Eighteen, “The Crisis of Industrial Capital,” 544-86.

³⁴ Carl Sandburg, *Chicago Poems: Unabridged* (1916; Dover Publications, 1994), 1.

³⁵ Leo Melamed, “Chicago’s Future in Futures,” Speech Presented at the 23rd Annual fall Management Conference, Northwestern University, Evanston, Ill November 7, 1973 [p.1], CME Series 2, Box 66, Folder 2.

³⁶ Leo Melamed, “Chicago’s Future in Futures,” Speech Presented at the 23rd Annual fall Management Conference, Northwestern University. Evanston, Ill November 7, 1973 [p.1], CME Series 2, Box 66, Folder 2.

³⁷ Leo Melamed, “Imagination,” Speech Presented to Nihon Keizai Shimbun Seminar on Japanese Financial Markets, New York, NY, September 22, 1987, [p.1], CME Series 2, Box 66, Folder 6.

support services.”³⁸ “Futures are one of the principle [sic] industries of Illinois and are a predominant business factor of the City of Chicago. Indeed, futures and Chicago have become synonymous.”³⁹

The financial futures market ushered Chicago’s evolution into a postindustrial economy. Unlike other deindustrializing midwestern cities, like Detroit, Chicago was on the path to economic growth. Melamed recognized the importance of this transition: “the exchanges were part of the rapidly growing service industry that was replacing manufacturing in America. And financial markets would someday replace the agricultural markets as the dominant futures markets.”⁴⁰ Within ten years of creating the IMM, “The annual payroll of exchange employees alone is above \$10 million, insignificant compared with some 20,000 people employed by Chicago member firms with annual payrolls close to \$250 million.”⁴¹ The downtown tax base was revitalized as “exchange and member firms rent approximately 1.5 million square feet of space in the City of Chicago. That is approximately 5 percent of total loop office space. Their annual rental payment brings about \$17.5 million to real estate owners in Chicago. The exchanges themselves pay more than \$2 million annually in real estate taxes on owned property.”⁴² By the early 1980s, Melamed’s financial futures were the future of Chicago.

But Melamed was not content. He began to look towards new financial products. He turned east, towards the financial center of the world: the New York Stock Exchange (NYSE). What if traders could speculate and hedge on the prices of stocks? Was there a neutral way to

³⁸ Melamed & Tamarkin, *Escape to the Futures*, 209

³⁹ Leo Melamed, “Patriotism,” Speech Presented at the Seminar for Illinois Congressmen, Chicago, IL, June 20, 1979 [p.2], CME Series 2, Box 66, Folder 3.

⁴⁰ Melamed & Tamarkin, *Escape to the Futures*, 263.

⁴¹ Melamed, “Patriotism,” Speech Presented at the Seminar for Illinois Congressmen, Chicago, IL, June 20, 1979 [p.3], CME Series 2, Box 66, Folder 3.

⁴² Melamed, “Patriotism,” Speech Presented at the Seminar for Illinois Congressmen, Chicago, IL, June 20, 1979 [p.3], CME Series 2, Box 66, Folder 3.

gauge the economic fundamentals of a marketplace as diverse as the NYSE? What new riches could be produced by financialized futures?

Melamed is often “credited with the idea of stock index futures.”⁴³ However, he instead gives credit to CME trading legend, Elmer Faulkner. According to Melamed, soon after the introduction of currency futures, Elmer—cigar in hand—told him in an excited whisper: “The ultimate futures contract is stock market futures.”⁴⁴ Captivated by the idea, Melamed inquired “Why hasn’t anyone done it?” “You can’t make delivery” was the succinct answer.⁴⁵ The new market, and its inherent problem, consumed Melamed. A future contract that could measure the entirety of the New York Stock Exchange would generate billions for the CME. It was “The Ultimate Contract”—all that stood in the way was a hundred years of jurisprudence focused on the concept of physical delivery. This small conversation would eventually revolutionize not only the futures market, but also the NYSE and the American economy in whole. In order to fully understand this, however, we must first examine stock index funds and the role of physical delivery in the history of the futures market.

Prompted by the slowing pace of the American economy, inflation, and loosening regulations throughout the 1970s, financial analysts began to formulate new products for the market. In San Francisco, a “team of computer geeks and misfit bankers” began to employ new economic theories in investment strategies. Chief among these theories was the “efficient market hypothesis.” Though not entirely new in the decade, the theory became famous due to economist

⁴³ Melamed & Tamarkin, *Escape to the Futures*, 291.

⁴⁴ Leo Melamed, “The Good Old Days: The October 1987 Stock Market Crash: A Futures Market Perspective,” Speech Presented to Securities Regulation Institute, San Diego, California January 26, 1989, [p.7], CME Series 2, Box 67, Folder 1.

⁴⁵ Melamed, “The Good Old Days: The October 1987 Stock Market Crash: A Futures Market Perspective,” Speech Presented to Securities Regulation Institute, San Diego, California January 26, 1989, [p.7], CME Series 2, Box 67, Folder 1.

Eugene Fama’s “Efficient Capital Markets: A Review of Theory and Empirical Work” in 1970.⁴⁶ According to Fama, asset prices reflect all the available information within the entire market. Prices are not set by a few government regulators, but rather everyone who partakes in the economy. The true value becomes inherently agreed upon. Thus, it is impossible to “beat the market”—one financial advisor cannot be smarter than the collective whole of every financial participant in the entire world.

The logic behind this theory reveals a central aspect to capitalism that many free-market advocates would like to ignore. That is, capitalism is inherently social. While Fama, Friedman, and others would argue that less government regulation spurs individual freedom, and thus innovation and wealth production within the marketplace, the underpinning logic is that a market is the result of millions of individual choices that come together to create a collective agreement. Price is “discovered” socially. Likewise, the market is not formed and set by a single entity, but rather is the result of millions of interactions. Capitalism is socially constructed. Although throughout this era, and today, it is constantly propagandized as inherently individualistic.

At the time, this theory was yet another stake through the heart of the failing New Deal Order. The government was unable to command and control the complexity of the marketplace; only the collective knowledge of every market participant could determine true values. For the team of financial analysts in San Francisco, the theory provided a framework for a sure-fire investment scheme. Because you cannot beat the market itself, why not join it—as in, the entire aggregate market? This is what an index fund attempts to do.

⁴⁶ Eugene F. Fama, “Efficient Capital Markets: A Review of Theory and Empirical Work,” *The Journal of Finance* Vol. 25, no. 2 (1970), 383–417, <https://doi.org/10.2307/2325486>. In 1960, two students at the University of Chicago, 1960 by Edward Renshaw and Paul Feldstein, were the first to propose a theoretical model for index funds. See Justin Fox, *The Myth of the Rational Market* (HarperCollins, 2011), “Chapter 7: Jack Bogle takes on the performance cult (and wins),” 111–12.

Index funds are a financial product that is composed of a “basket” of underlying stocks that aim to measure the entire marketplace. The two most famous index funds are based on the Dow Jones Industrial Average (Dow), and the Standard and Poor 500 (S&P 500). The Dow is composed of thirty prominent companies listed on the NYSE. The list is revised over time as companies fall out of profitability. For example, Apple replaced AT&T in 2015 and Walgreens replaced General Electric in 2018.⁴⁷ The S&P 500, as the name implies, is composed of the five hundred largest companies listed on the NYSE.

Investment firms invest in underlying stock and sell it as a single package to investors. Although developed by bankers in San Francisco, The Vanguard Group, a private equity/investing company, was the first to successfully sell index funds to the general public in 1975. Soon after, index funds became key investment strategies for pension funds as they offered very low risk and high returns. For example, the average annual return on the Dow in 1976 was 23.84 percent; the average return for every dollar invested was \$1.51. Stock indexes continue to be a central strategy for retirement accounts. If you are lucky enough to have one, check your 401K. Chances are that a majority of your money is invested in a package that tracks either the Dow or the S&P 500.⁴⁸

In and of themselves, the creation of index funds was not necessarily a world rattling event. However, index funds do represent a key idea in financialization that will play an increasingly more important role in the pages ahead. That is, during this era, the measurement of assets began to turn into an asset themselves.⁴⁹ Investors in the S&P 500 were not speculating on

⁴⁷ Steve Lohr and Michael J. de la Merced, “G.E. Breaks Up With Its Storied Past,” *New York Times*, November 10, 2021, <https://www.nytimes.com/2021/11/09/business/general-electric-break-up.html>. The Dow currently represents the American economy with companies focusing on Financial Products, Healthcare, Fast Food, Entertainment, and Consumer Goods dominating the list.

⁴⁸ Thomas Riggs, Editor, *Gale Encyclopedia of U.S. Economic History*, Vol. 3 (2nd ed., 2015), “Standard & Poor's” 1256.

⁴⁹ Lisa Adkins, Melinda Cooper, and Martijn Konings, *The Asset Economy* (Policy Press, 2020), 14.

the future prices of wheat. Rather, they hedged that the S&P 500, an aggregate measurement of a diverse array of underlying stocks—meaning corporations—would grow over time. It was treated as a single asset that could be invested in. It is as if the corporations that composed index funds were the same as the individual grains of wheat that created the bushels that were bought and sold as a single “wheat” commodity on the futures market.

If the S&P 500, or Dow, could now be bought and sold on the open market, why not trade futures on them? For Melamed, this idea “stayed buried in [his] mind and haunted [him] for years.”⁵⁰ There was a problem that first had to be overcome: physical delivery. As noted previously, futures contracts were a form of financial exchange where neither party had the physical commodity in hand. Again, to use wheat as an example, a futures contract on “September wheat” was a binding agreement about the sale of wheat that had not actually been grown, nor even planted. The construction and final execution of the contract meant that “no physical goods were ever delivered.”⁵¹

By the end of the nineteenth century, the nature of the futures market became the center of a contentious legal battle. Futures contracts broke a key principle rooted in Anglo-American common law that identified legitimate market exchange as a transfer of physical goods across space. One could harvest wheat in Minnesota and sell it to the Chicago market via railroad. However, futures contracts were selling *imaginary wheat* through time, not physical good across space. What, then, was the difference between buying and selling wheat that would not exist for years and purchasing a claim that a ball would land on red on a roulette table within the next thirty seconds? Were futures traders just gamblers?⁵²

⁵⁰ Melamed & Tamarkin, *Escape to the Futures*, 292.

⁵¹ Levy, *Freaks of Fortune*, 231-32.

⁵² Cronon, *Nature's Metropolis*, 231-263; Levy, *Freaks of Fortune*, 231-40.

The answer was, of course, no. Or, perhaps more accurately, not exactly. Futures contracts were recognized to have a special public good. As previously noted, they allowed growers to insure their investment by hedging against the risk of unforeseen downward price movements. In doing so, they helped stabilize the price of wheat internationally. Yet, they were seen as highly speculative endeavors that had an aura of immorality. Throughout the latter half of the nineteenth century, small exchanges, known as “Bucket Shops” traded wheat futures. These bucket shops helped smaller farmers who did not have access to the Chicago exchanges to participate in the insurance policy of commodity futures. They were, however, also highly informal. Anyone could buy or sell small futures contracts. This led to an impression that these shops were more akin to gambling dens rather than anything of real economic value.⁵³

In order to resolve the issue, the United States Supreme Court, under the guiding hand of Justice Holmes, split the difference between pure imagination and physical delivery of commodities. Holmes ruled that traders had to “contemplate delivery” when they were trading futures contracts. This means that traders had to recognize, even just within their own mind, that physical wheat would, eventually, be delivered to the market. Traders were not completely untethered from the real world. Furthermore, futures trading would be limited to exchanges registered to state governments, thus creating a government-backed monopoly that would ensure price stability, expertise, and eliminate secondary markets that could be mistaken for gambling dens. Physical delivery of wheat tied the futures markets to the material world. The price of wheat futures would link with the price of actual wheat on a given day because occasionally a trader would have to take or deliver wheat at the going market price at a grain elevator.⁵⁴

⁵³ Levy, *Freaks of Fortune*, 231-35.

⁵⁴ Diana B. Henriques, *A First-Class Catastrophe: The Road to Black Monday, the Worst Day in Wall Street History* (Henry Holt and Co., 2017), 54-55.

However, a stock index fund is not wheat. Melamed knew that “it was impossible to deliver a properly weighted portfolio with each of the stocks in the index” because it was impossible to “deliver 30 Dow stocks ... with splits and dividends and the constant changes in the list of stocks” to a buyer.⁵⁵ The answer for Melamed was clear: “Cash settlement in lieu of physical delivery enables us to contemplate and explore market applicability in virtually every facet of human endeavor”⁵⁶ Forgoing the need to physically delivery for cash settlement—allowing traders to simply pay a cash amount based on the level of an index or price as specified within the contract⁵⁷—would allow the CME to have “stock indexes and lord only knows what else.”⁵⁸ It would open the marketplace to invention, allowing new financial products to generate ever more wealth.

Cash settlement would fundamentally alter how futures contracts work. First, there was the structural issue of how the markets functioned. Futures contracts for specific agricultural items were by law given to only one exchange. The Chicago Board of Trade had a monopoly on the wheat and grains futures market. The Chicago Mercantile Exchange had their pork bellies. If you wanted to trade futures for these products, you had to engage with these institutions. Thus, the price of wheat futures decided upon within CBOT defined the price of wheat worldwide—there was no secondary market to trade. Of course, this was not true of the Dow or S&P 500. Their price is not determined in Chicago, but rather on the floor of the New York Stock Exchange. Without physical delivery directly connecting the two exchanges, the price of a

⁵⁵ Melamed & Tamarkin, *Escape to the Futures*, 292.

⁵⁶ Leo Melamed, “The Future of Futures” Speech Presented to The New School for Social Research, New York, NY, October 28, 1983, [p.3], CME Series 2, Box 66, Folder 4.

⁵⁷ Cash Settlement as defined by the Commodity Futures Trading Commission: A method of settling futures options and other derivatives whereby the seller (or short) pays the buyer (or long) the cash value of the underlying commodity or a cash amount based on the level of an index or price according to a procedure specified in the contract. See, *The Commodity Futures Trading Commission*, “Glossary,” https://www.cftc.gov/LearnAndProtect/EducationCenter/CFTCGlossary/glossary_c.html, last visited December 6, 2022.

⁵⁸ Melamed & Tamarkin, *Escape to the Futures*, 292.

futures contract on the Dow could rise above or fall under the price of the actual stocks on the NYSE. Allowing cash settlement and index fund futures would essentially create two marketplaces.⁵⁹

The fracturing of the market, however, was not considered by Melamed and his team. Instead, all focus was on how prove that it was not “merely the invention of legalized form of gambling.”⁶⁰ As we just read, physical delivery—even just contemplating delivery—was the legal crux that separated futures markets from gambling dens. Although the solution blurred the line between an imagined future and the real-world commodity price, contemplating physical delivery still rooted the exchanges in the lived, material present. Eliminating this would break the connection to the physical world as established by Justice Holmes’ ruling, allowing the CME to fully enter a world of imagination. Any price could be made, as long as some other trader was willing to sign the contract. The Chicago exchanges, already highly speculative as compared to the NYSE at the time, would become fully unbound from reality. Pure speculation could rule the marketplace.

Melamed probably did not have any of in his mind in the late 1970s. He just wanted to expand the financial futures marketplace and make the CME money. Throughout the decade, Melamed continuously touted that “Commodity trading is not a game or a gamble.”⁶¹ In fact, just the opposite as “One must approach commodity trading as a business venture and apply good

⁵⁹ The answer to this enigma is price arbitration. Third-party traders would connect the prices of the two markets by buying low in one exchange and selling high in another. This is a central concept that will be fully explored in the next chapter.

⁶⁰ Leo Melamed, “A Futures Market in Currency,” Speech Presented to the New York Society of Security Analysts, New York, NY, April 19, 1972, [p.1], CME Series 2, Box 66, Folder 2.

⁶¹ Leo Melamed, “A Professional’s View of Commodity Trading: A Compendium of the Remarks of Leo Melamed, Chairman of the C.M.E. Board, 1969-70-71, and the I.M.M Board 1972-73 Before the Financial Editors Seminars of Nov 10 1969 and Nov 28,” 1972, [p.1], CME Series 2, Box 66, Folder 2.

business techniques and judgement.”⁶² He knew cash settlement was associated with gambling; and he knew the solution: “only a federal agency could ordain the legitimacy of cash settlement.”⁶³ Melamed needed his own Justice Holmes who would recognize the economic opportunities of index futures trading and remake the law to generate new capital flows.

That man was Phil Johnson. Named the head of the Commodity Futures Trading Commission (CFTC), a regulatory branch formed by the Congressional Agricultural Committee after the successful implementation of Melamed’s foreign currency futures market, in 1974. By 1981, Johnson was a strong ally of Melamed. This is probably because Johnson was named chairman “principally as a result of [Melamed’s] strong lobbying efforts.”⁶⁴ But more than that, unlike his predecessor, James Stone, Johnson was a futures and derivatives products attorney who was well versed and highly connected to the futures markets. He understood Melamed’s vision and set a path forward to work out a deal with the Securities and Exchange Commission (SEC) to allow for cash settlement.

In 1981, the CFTC allowed cash settlement in some futures markets. Pushed not by index funds futures, but rather another Melamed idea of Eurodollar futures (another currency market), Johnson’s CFTC recognized the economic need to expand futures trading into financial products and the antiquated limitation that physical delivery created. The need for new markets, and the increased liquidity they produced, replaced the nineteenth century fear of immoral gambling on the market. After all, economic actors were rational thinkers who, by working in their best interest, invented new paths to wealth creation.⁶⁵

⁶² Leo Melamed, ““A Professional’s View of Commodity Trading A Compendium of the Remarks of Leo Melamed, Chairman of the C.M.E. Board, 1969-70-71, and the I.M.M Board 1972-73 Before the Financial Editors Seminars of Nov 10 1969 and Nov 28,” 1972, [p.1], CME Series 2, Box 66, Folder 2.

⁶³ Melamed & Tamarkin, *Escape to the Futures*, 292.

⁶⁴ Melamed & Tamarkin, *Escape to the Futures*, 292.

⁶⁵ Pamphlet: “Inside Eurodollar Futures” by Chicago Mercantile Exchange (1984), CME Series 2, Box 42, Folder 5.

Stock index futures were now possible. Melamed had been working behind the scenes to be ready for this moment for nearly two years. He did not wait for approval of cash settlement to launch the strategy for Elmer Faulkner's ultimate contract, and instead, worked with the Standard & Poor's Corporation to create a contract on selling futures for the S&P 500 at the CME. On April 21, 1982, the CME was first in line for a cash-settled index contract. "The era of index futures was now upon us" Melamed remembered as "cash delivery . . . single-handedly unshackled futures from its most trying constraint."⁶⁶ The S&P 500 index fund would become "the most successful stock index futures contract in the world."⁶⁷ It catapulted Melamed to financial fame and, more importantly to the CME, bolstered its revenues and reputation. It even funded the development of the Exchange's new headquarters in downtown Chicago. For the first time in its history, the CME rivaled the mighty Chicago Board of Trade.⁶⁸

It is important to remember that the success of the S&P 500 index futures "would most likely never have transpired without the existence and courage of the Commodity Futures Trading Commission."⁶⁹ As with the wheat futures of the nineteenth century, financial futures only become a real entity when they are made possible by legal backing. Government, law, and the market remained deeply interconnected, even through the deregulatory period of the 1980s. Financial futures capitalize, in the present, future revenue flows. They were "instruments which

⁶⁶ Leo Melamed, "New Rules, New Game: Keeping Pace with the Marketplace," Speech Presented at Options and Futures Strategies for Portfolio Managers, Coronado Ca, February 16, 1987, [p.4], CME Series 2, Box 66, Folder 6; Melamed, "The Future of Futures" Speech Presented to The New School for Social Research, New York, NY, October 28, 1983, [p.3], CME Series 2, Box 66, Folder 4.

⁶⁷ Leo Melamed, "The Good Old Days: The October 1987 Stock Market Crash: A Futures Market Perspective," Speech Presented to Securities Regulation Institute, San Diego, California January 26, 1989, [p.7], CME Series 2, Box 67, Folder 1.

⁶⁸ Leo Melamed, "1989 Membership Address," Presented at the November 28, 1989 CME Semi-Annual Members' Meeting CME Upper Trading Floor Chicago, IL, CME Series 2, Box 67, Folder 1.

⁶⁹ Leo Melamed, "The Future of Futures," Speech Presented to The New School for Social Research, New York, NY, October 28, 1983, [p.3], CME Series 2, Box 66, Folder 4.

blurred the age-old distinction” between corporal and imagined.⁷⁰ These claims are only made possible when they, as contracts, are backed by legal instruments and the state. The regulatory department of the CFTC not only watches over the financial futures market, its existence is necessary for the market to exist.⁷¹

In 1982, all was well in the Chicago futures markets. The CFTC made cash settlement legal, allowing the creation of index funds futures and all the wealth production Melamed envisioned. But this is not the end of the story. Another regulatory agency—the Securities and Exchange Commission—doubted the entire scheme. What began as a small disagreement turned into an all-out legal battle over another new financial futures market—government-backed mortgages. The SEC argued that the CFTC only had jurisdiction over commodities—mortgages, and by extension, index funds, were securities, thus under the purview of the SEC. This battle would ultimately make Congress decide what was a security, what was a commodity, and, unintentionally, solidify the central role of finance in the American economy.

It is important to remember that Melamed was only part, not the cause, of rapid changes to the economy that blurred the once clear distinction between the futures market and other financial instruments. In 1973, the Chicago Board of Trade began efforts to apply “the futures trading concept in new and untried areas.” These new untried areas were, like index funds, located mostly within the NYSE. The CBOT began to develop futures contracts based on NYSE-traded corporate shares. The details to this scheme are complicated and rather confusing; however, the key point to consider is that CBOT created futures based on securities. A security, by definition, is a tradable financial asset. Corporate Stocks, mutual funds, and bonds issued by

⁷⁰ Melamed, “The Future of Futures,” Speech Presented to The New School for Social Research, New York, NY, October 28, 1983, [p.2], CME Series 2, Box 66, Folder 4.

⁷¹ Adkins, Cooper, and Konings, *Asset Economy*, 14-15.

the government or private entities are all securities. As its name would suggest, the Securities and Exchange Commission oversees regulation regarding these financial assets. Accordingly, the CBOT was required to work with the SEC to get their newly developed financial futures to the marketplace.⁷²

The ensuing partnership could best be described as strained. The SEC was formed after the Crash of 1929 with a mandate to prevent market manipulation. These regulators eyed the CBOT, and frankly the entire futures market, with distrust. Futures were inherently more speculative up to that point in time than anything Wall Street had done since the creation of the SEC. Unlike Melamed's relationship with the CFTC, the SEC viewed the CBOT with skepticism, focusing on the similarities between futures trading and gambling.⁷³ An agreement was eventually made and the SEC allowed the CBOT contracts to start trading in 1973. However, the regulations for the new CBOT contracts were more stringent than any other futures contract. The SEC required high collateral and banned short selling in order to keep speculation to a minimum.⁷⁴ Although the deal was made, many CBOT traders were not pleased. Short selling is a key strategy for many futures traders, and high collateral requirement simply kept many investors from fully taking part in the new market.

The labored interaction with the SEC influenced CBOT members as they worked to develop a futures market based on a promising new source: mortgage securities. In 1975, the same time that Melamed was developing his futures market in foreign currency, the federal government began to allow "home mortgages ... to start trading as futures" in order to spur

⁷² Chris Muellerleile, "Speculative boundaries: Chicago and the Regulatory History of US Financial Derivative Markets," *Environment and Planning*, Vol. 47, 2015, 1812-13.

⁷³ The CFTC did not exist at this point, which is another reason the CBOT had to contend with the SEC.

⁷⁴ Muellerleile, "Speculative boundaries," 1813.

investment into the U.S. housing market.⁷⁵ These mortgage futures were made available by the Federal Home Loan Mortgage Corporation, known as Freddie Mac. Established in 1970 to “stimulate the market for conventional home mortgages. . . . Freddie Mac sells its own securities publicly. It then invests the cash in conventional mortgages, which generally carry a higher interest rate and covers more expensive homes than those backed by the Veterans Administration or the Federal Housing Administration.” These mortgages target home buyers who do not qualify for VA or FHA loans. The vice president of Freddie Mac explained that “if a builder can be freed from money market risk by mortgage futures contracts, he could offer homes at a lower price.” Much like wheat, futures on mortgages securities would help to stabilize the market by allowing speculators to alleviate some risk from extreme price fluctuations by buying “at or near a low and sell at or near a high,” thus moderating “[market] swings by balancing panic selling, and reduce the peak price by furnishing additional supplies when demand is excessive.” In total, futures speculators would “help reduce the boom-bust cycle in housing” and help more Americans purchase their homes.⁷⁶

Freddie Mac’s entrance into the futures market was followed by its sister institution, Government National Mortgage Association (Ginnie Mae) in 1980. Whereas Freddie Mac created and secured mortgages, Ginnie Mae guarantees the payment of principal and interest by approved private lenders. They do not create the loan itself but instead guarantee a private loan in order to facilitate affordable home loans for underserved consumers in the mortgage market. Thus, the loans themselves were not owned by the government and could be traded on the public market. CBOT began to work to develop futures for Ginnie Mae securities. However, as a security, futures on Ginnie Mae contracts would go through the SEC, rather than the newly

⁷⁵ Elizabeth M. Fowler, “Futures Trading In Home Mortgages,” March 23 1975, *New York Times*, 159.

⁷⁶ Fowler, “Futures Trading In Home Mortgages,” March 23 1975, *New York Times*, 159.

developed, and as Melamed's experience illustrates, much more accommodating regulator, CFTC. The SEC's reluctance to embrace short selling and other more speculative aspects of the futures market would remove much of the incentive to trade Ginnie Mae securities. However, if they were considered *commodities*, then jurisdiction would fall under the CFTC.

It is worth taking a moment to clarify. Despite the abundance of acronyms, the dynamics of the situation are relatively simple. The federal government began allowing futures based on mortgages to be traded on the marketplace. Ginnie Mae backs privately held mortgages, meaning it helps pay what the borrower owes in case of financial hardship in order to spur investment in people who historically would not be approved for home loans. Because these are private contracts, they could be traded on the open market. CBOT wanted to capture that market. However, because mortgages are considered securities, the much more risk-adverse agency, the SEC, would regulate the market. Much like with Melamed and the CFTC, the government created the framework for the futures market to exist. However, unlike the CFTC, the SEC set much narrower parameters to operate within, thus limiting speculation and profit.

In order to counter this, CBOT simply argued that once traded as a future, the mortgage-backed security became a commodity because only commodities could be traded on the Chicago futures market. Thus, the CFTC had regulatory control. This was essentially a form of capitalist transubstantiation. The SEC had none of this argument. A security was a financial asset—mortgages being one of the main types of securities in the U.S. economy. There was no magic, once a security, always a security. A commodity had long been understood as a raw material—almost always agricultural—that could be bought and sold. Wheat, coffee, tin, copper, and gold. For the SEC, the line between agriculture and financial futures remained clear and fixed. So, CBOT did what any American would and sued the SEC, arguing that it has no “authority to

regulate trading in options on [Ginnie Mae certificates] given that GNMA's are both 'commodities' and 'securities.'”⁷⁷

CBOT’s argument did not appear out of thin air. In fact, they were following the logic created by the CFTC in the previous year. In 1974, Melamed’s buddy, Philip Johnson, became the head of the agency. At the time, the CFTC’s authority was limited to specific physical products—wheat and other forms of common commodities.⁷⁸ Johnson knew this had to change to support the creation of new financial futures markets. In order to stake out a claim to regulate these financial futures, Johnson added a clause stating that the CFTC’s role in regulating future’s markets gave it jurisdiction over anything traded on the futures market, no matter what the future was derived from. (These are known as derivatives—the value of the contract *derives* from an underlying asset.) Futures based on physical commodities were the same as those based on “all other goods and articles ... and all services, rights and interests in which contracts for future delivery are presently or in the future dealt.”⁷⁹ As a result, Melamed’s foreign currency futures and stock index funds, as well as CBOT’s Ginnie Mae mortgage securities, were under the domain of CFTC regulation.

The lawsuit between CBOT and the SEC underlines fragility of Johnson’s maneuvering. The SEC—created forty years earlier in order to prevent another financial calamity—did not take kindly to the upstart CFTC encroaching on its turf. More to the point, however, was the question of the possibility for one regulatory agency to simply say they oversee actions that historically

⁷⁷ *Board Of Trade of the City Of Chicago, v. Securities and Exchange Commission*, 677 F.2d 1137 Fed. Sec. L. Rep. P 98,605, No. 81-1660. United States Court of Appeals, Seventh Circuit. Argued Nov. 4, 1981. Decided March 24, 1982, <https://openjurist.org/677/f2d/1137/board-of-trade-of-city-of-chicago-v-securities-and-exchange-commission>.

⁷⁸ Henrique, *A First-Class Catastrophe*, 31.

⁷⁹ U.S. Congress, House, *Commodity Futures Trading Commission Act*, H.R.13113, 93rd Congress, 2nd Session, 1974; Henrique, *A First-Class Catastrophe*, 31; Richard Sandor, *Good Derivatives: A Story of Financial and Environmental Innovation* (John Wiley, 2012), 98-99; Muellerleile, “Speculative boundaries,” 1816.

belonged to another. However, neither the SEC and CFTC wanted, nor anticipated, the plethora of law suits—with the CBOT case as the most prominent—that emerged after 1974.

In order to quell the confusion, Johnson began to meet with the SEC chairman, John Shad, to work out an agreement. At first, Shad would not move from his position, arguing that all futures based on securities—even those traded on CFTC markets based in Chicago—were under the domain of the SEC because they were securities, and thus under the jurisdiction of the *Securities and Exchange Commission*. However, through negotiation, Shad was convinced that the SEC did not have the full capacity to regulate futures contracts—they were highly specialized financial transactions that should be left to specialists at the CFTC. Furthermore, neither chairman wanted to be the one responsible for curbing the expansion of the financial market—nor the bad press that came from what was seen as a turf war between two government agencies.⁸⁰

By 1981, the two had worked out an agreement. The Shad-Johnson Accord outlined clear boundaries between the two agencies in order to establish an environment that both supported, but regulated, the growing use of financial products in New York and Chicago. Principally, the agreement stated that the CFTC would have exclusive jurisdiction over futures contracts based on securities indices, foreign currency, and some government securities—including Ginnie Mae mortgages. Melamed's foreign currencies and index funds futures were reconfirmed as legal, and the CBOT was allowed to proceed with Ginnie Mae contracts without opposition from the SEC.⁸¹

⁸⁰ H.j. Maidenberg, "Difficult Task Faces Chairman of C.F.T.C.," *New York Times*, June 15, 1981, Section D, page 1; Henriques, *A First-Class Catastrophe*, 54.

⁸¹ E. Gerald Corrigan and Evelyn F. Carroll, "Meeting the Challenges of a New Banking Era," *Federal Reserve Bank of Minneapolis Annual Report 1981*, January 1, 1982; "SEC/CFTC Agreement [Shad-Johnson Accord]," <https://www.cftc.gov/sites/default/files/opa/press00/opaagreement.htm>.

For a few weeks, all was well within the financial world. Then the Seventh Circuit Court of Appeals handed down judgement on the *CBOT v. SEC* case. The court found that “pending further action by the Commodity Futures Trading Commission (CFTC), all trading of options on GNMA's is prohibited and that the SEC has no jurisdiction of its own to permit trading in GNMA options.” Because Ginnie Mae certificates were both commodities and securities, neither agency had direct oversight as the law was written. The court held that the question of what agency did what was beyond the scope of the judicial branch. Only Congress could legislate clear definitions of the boundaries between both agencies. The ruling effectively ended the informal accord and pushed the debate to the halls of Congress.⁸²

If you are confused by all of this, it is simply because it is all very confusing. However, confusion is an essential part of the political-economy of this era. Once again it is necessary to take a step back to understand all that had occurred. Throughout the 1970s, financial traders—the Melameds of the world—began to develop new instruments that could be bought, sold, and traded on market exchanges. These products mostly fell under two broad categories—the measure of commodities was being turned into commodities themselves, such as index funds; and a claim on anticipated future revenue flows became central to wealth generation, such as Ginnie Mae futures. Both categories, broadly conceptualized, depend on the imagination of both the buyer and seller. They are not dealing directly with real, material goods. The actual stock, or mortgage, is not only being bought or sold—but rather the speculative *future* price of the underlying good is being traded. As stated before, the essential aspect to this speculation is the support by the law and government. This is why the contention between the SEC and CFTC was important—the SEC would effectively limit or even ban these newly developed and highly

⁸² *Board Of Trade of the City Of Chicago, v. Securities and Exchange Commission*, 1 & 44, <https://openjurist.org/677/f2d/1137/board-of-trade-of-city-of-chicago-v-securities-and-exchange-commission>.

profitable products, and the CFTC would make them legal, and thus real. Furthermore, the contention between the two agencies illustrates that the growth of the financialized economy was not a smooth, well-ordered thing. There was no master plan. The growing “neoliberal” ideology did not provide a clear road map. In fact, as we have seen, the market often outpaced the government in terms of defining what was possible. In the end, Congress would be the final arbiter as to what exactly the financial economy would look like.

In early February 1982, the House Agriculture Committee set out to resolve the uncertainty surrounding financial futures. After a quick debate, H.R. 5447—the Futures Trading Act of 1982—was introduced to the full House. The bill set out to resolve the key issues behind the Seventh Circuit ruling by codifying the Shad-Johnson agreement and renewing the CFTC’s regulatory authority, which was due to expire on September 30, 1982. Although the bill moved through Congress at almost record speed (it was made law in January of the following year), a close analysis of key congressional deliberations illustrates how lawmakers understood the impact of financial futures specifically, and the shifting economy more generally. These themes range from how lawmakers framed and understood the legislation, the shifting nature of the U.S. economy from industrial to postindustrial/finance driven, the continuing debate about the role of speculation & gambling, how the government can properly regulate during a time of deregulation, recognition of the growing role of financial products (and those who create them) in the economy, and finally, the economic utility of these new products.

The purpose of the Futures Trading Act of 1982 was clear to members of Congress. The bill “attempts to codify an agreement between the CFTC and the Securities Exchange

Commission regarding the overlapping jurisdiction of the two agencies.”⁸³ Michigan Democratic Representative, David Bonior, accurately explained that “Until recently, the jurisdiction of the two agencies was relatively clear. The SEC oversaw and regulated transactions on securities—investment stocks and bonds, certificates of deposits, and so forth. The CFTC was given regulatory responsibility over futures transactions, which were primarily in agricultural commodities and natural resources.” These were two separate markets falling under clear regulatory divisions. However, “that jurisdictional distinction has been blurred in recent times by the proliferation of creative financial instruments called securities options that resemble futures transactions even though the underlying instruments are securities.” It was thus up to the Congress to define the role of both the CFTC and SEC in the changing marketplace.⁸⁴

There was little debate over the long-term impact of the bill. Instead, the bill was framed as a necessary solution to solve an immediate problem. “The bill was introduced with bipartisan sponsorship. It was passed unanimously by the Subcommittee on Telecommunications, Consumer Protection and Finance and by the Energy and Commerce Committee. It has the support of both the SEC and CFTC.”⁸⁵ In fact, at one point a Senator exclaimed that the debate was “so harmonious that one can almost hear the choir singing in the Chamber here today.”⁸⁶

It is important to take a moment to consider how a smooth legislative process illuminates historical actors’ understanding of their decisions long-term impact. The “harmonious” chamber never fully considered how securities, once transformed into commodities, would affect the American economy. Instead, securities and commodities futures continued to be recognized as

⁸³ Representative David Bonior, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24905.

⁸⁴ Representative David Bonior, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24905.

⁸⁵ Representative Timothy Wirth, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24909.

⁸⁶ Representative Robert Walker, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24905.

two separate markets, with a small overlap that the Shad-Johnson Agreement resolved. As described by Representative William Wampler (R VA):

both the CFTC and the SEC worked long and hard to establish a clearly defined regulatory scheme designed to protect the public In resolving questions of jurisdiction over such instruments generally defined as “financial futures” or “financial options,” the agreement ratifies the inherent difference between the futures industry and securities industry and endorses the concept of separate regulation. Basically, the CFTC will retain its traditional role of regulating markets and instruments that serve a hedging and price discovery function while the SEC will regulate markets and instruments with an underlying investment purpose.⁸⁷

Securities remained securities, under the purview of the SEC, and futures were commodities, under the CFTC.

Except, of course, when a security transformed into a commodity when it was sold in the futures market. Although the law made this magic of the marketplace real, there was no debate as to what exactly this meant. Instead, the problem was framed as one where jurisdictional lines had “blurred,” yet there was also an “inherent difference between the futures industry and securities industry.” The solution was clear to the Congress—let the CFTC regulate commodities, even those that had transformed from a security. As we will see in the next chapter, this fundamental misunderstanding—that what were once two markets had fused into one—helped to fuel the Wall Street Crash of 1987. The point here, however, is to illustrate that congressional representatives did not fully understand the changing dynamics wrought by the new financialized

⁸⁷ Representative William Wampler, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24912.

markets. A security, originated in the NYSE, remained a security even as it became a futures commodity traded in Chicago. A simple hand-off of regulatory oversight was all that was needed to ensure a safe and well-functioning marketplace for the American public.

The confusion of congressional representatives is not completely unexpected. Very few were adept in understanding the subtle nuances of financial instruments. That is why the Shad-Johnson Agreement was held in such high regard. The two key regulators who specialize in finance worked through the weeds and presented a clear solution. Never mind that both regulators were more concerned about the future of their own agency than the long-lasting economic effects of their solution.⁸⁸

The shortcomings of congressional knowledge, however, is key to understanding how the new political economy of financial production was created. This point is best understood by analyzing the role of the Farm Bloc in creating and passing the Financial Futures Act of 1982. As examined in chapter one, the Farm Bloc remained a powerful force within Congress through the 1980s (and today) due to the sheer number of states with substantial agricultural sectors. The Shad-Johnson Agreement was, in terms of geographic origins, essentially an agreement between New York (SEC/securities) and Chicago (CFTC/commodities). Thus, the House Banking Committee could have rightfully taken control of the proceedings. Nonetheless, the “fathers of the legislation [was the] Agriculture Committee.”⁸⁹ Consequently, the committee that represented the oldest of American economic sectors came to shape the newest.

⁸⁸ John D. Benson, “Ending the Turf Wars: Support for a CFTC/SEC Consolidation,” *Villanova Law Review* 36, no. 5 (1991), 1175-1217.

⁸⁹ Representative Kika De La Garza, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24915.

Commodity futures, even for complex financial instruments centered on mortgages or the S&P 500, were understood as “vital and so important to American agriculture.”⁹⁰ Historically, this sentiment was correct as almost every futures contract was based on an agricultural product. However, the then newly developed financial instruments had little to do with agriculture. Representative De La Garza (D TX) admitted as much when stating that “The term ‘commodity’ has come to embrace a variety of financial instruments, precious metals, and natural resources items, such as petroleum, as well as domestic and international agricultural products.”⁹¹ Some members of the House, such as De La Garza, were not completely confused by the new distinction of financial instruments as commodities. They readily accepted that these futures contracts could be traded alongside traditional ones such as wheat and pork bellies. As Representative Glickman (D KS) stated: “Now a person is more likely to trade a futures contract on Treasury bills, Ginnie Maes, or stock indices than on pork bellies, oats, or cotton.” De La Garza added on, noting that “In the past 5 years, futures trading volume has nearly tripled, from 37 million contracts to more than 100 million contracts annually.”⁹²

The contention between the fact that financial futures contracts far outpaced traditional futures and the belief that futures were “vital” to agriculture seems obvious. What does the housing market, or foreign currency, have to do with wheat or corn? Unless you are buying property in the Dakotas, not much. Yet, members of the Agriculture Committee assumed that the new financial futures would benefit their home districts in the same way that agricultural futures had for a century. Analogous to the Tax Reform Act of 1986 and the Garn-St. Germain Act,

⁹⁰ Representative Kika De La Garza, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24915.

⁹¹ Representative Kika De La Garza, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24914.

⁹² Representative Kika De La Garza, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24914. Financial futures officially passed agricultural futures in 1981. See “Chicago Mercantile Exchange 1981 Annual Report, 1982, [p.6], CME Series 1, Box 1, Folder 18.

congressional representatives operated under the understanding that the post-Volcker Shock economy operated exactly as the industrial economy had. Futures, historically “vital and so important to American agriculture,” would continue to be, although the fundamental nature of futures were being transformed by the very legislation up for discussion.⁹³

While the transformation of futures contracts remained opaque to Congress, one classic concern remained as clear as ever: gambling. Paralleling the fears of nineteenth century legislatures, many members of the House remained concerned that “excessive speculation may occur on the futures markets and related options markets which are manipulated, controlled, cornered, or squeezed.”⁹⁴ The difference between needed economic speculation and outright gambling that futures contracts created became especially hazy once futures contracts could be fulfilled with cash settlement. So blurred, in fact, that the bill directly addressed “State gambling laws that might be construed to apply to options contracts, even though they are approved by the SEC.”⁹⁵ Specifically, the federal legislation under debate encountered “approximately 25 States [that] have gambling and bucket shop laws which could potentially be used to prevent trading of options settled in cash, such as options on stock indexes, even though such options contracts have been approved by the Securities and Exchange Commission.”⁹⁶ One hundred years of legal precedent was suddenly overturned. What was once the main concern of nineteenth century legislatures—cash settlement—was now deemed as necessary. Thus, it was deemed necessary to overrule state-level laws with federal legislation to support a growing sector of the economy.

Although the Chicago Mercantile Exchange and Chicago Board of Trade could never be

⁹³ Representative Kika De La Garza, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24915.

⁹⁴ Representative George Hopkins, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24905.

⁹⁵ Representative Richard Dingell, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24909.

⁹⁶ Representative Matthew Rinaldo, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24913.

confused as “bucket shops,” contracts emanating from their trading floors crept ever closer to what was once understood as gambling. In response, federal legislators attempted to account for the increasing role that pure speculation had in the U.S. economy.

Increased regulation of the financial industry was the obvious answer to quell the ever-expanding role of speculation in the economy. However, this was the 1980s. Deregulation was the name of the game, so increasing the CFTC in terms of employment and funding was a nonstarter. Some House representatives attempted to address the contention between these two contradictory ideas. Representative Larry Hopkins (R MI) succinctly addressed the concern and solution: “regulation is required because excessive speculation may occur on the futures markets and related options markets which are manipulated, controlled, cornered, or squeezed. To accomplish the regulatory goal of preventing such activity, the committee bill authorizes a broad spectrum of Commission and self-regulatory actions.”⁹⁷ Some new regulatory powers would be created for the CFTC. Specifically, “The committee bill authorizes the Commission to conduct rulemaking proceedings to set speculative limits for futures and options transactions.”⁹⁸ This meant that the CFTC could set limits to speculative investment by requiring more upfront capital for financial futures investments. Traders would not be allowed to borrow or use other non-money assets, such as stocks, to buy and trade financial futures. This “skin in the game” approach sought to suppress highly speculative strategies because traders would, in theory, be more conservative in their approach if they were forced to use cash. This did curb some speculation. However, as we will see in the next chapter, it also had dire consequences. Most of the investors who took advantage of the new financial futures had high capital reserves, or were

⁹⁷ Representative George Hopkins, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24905.

⁹⁸ Representative George Hopkins, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24905.

a conglomeration of multiple private investors' savings, such as hedge funds. The high entry point for investment essentially created a dynamic where huge market swings were more likely.

The bill, however, did not do much else in terms of direct regulation. Instead, “self-regulation” was touted as the main solution throughout the proceedings. Again, Representative Hopkins best summarizes: “I believe the committee bill, as evidenced by these amendments, strikes a responsible balance between meaningful Government regulation and oversight and direct self-regulation of the futures markets. Self-regulation is, after all, the heart of the regulatory scheme embodied in the Commodity Exchange Act.”⁹⁹ Self-regulation was recognized as a solution for two key reasons. The first was that the expanding futures marketplace was far too complex for any one agency to competently regulate. “The [CFTC] does not have the resources and cannot be expected to have the capability of surveilling every nook and cranny of the futures market.”¹⁰⁰ While this was true, the reasoning should reinforce the idea that, perhaps, more funding should go to the CFTC.

The second purpose for self-regulation addressed this point. No single agency, no matter how much funding it had, could regulate the intricacies of the financialized marketplace. Money moved too fast, to far too many places, under multiple forms, such as derivatives. Thus, it was up to the economic actors themselves to regulate. In fact, this was exactly how the futures marketplace was currently structured: “This ever-broadening sphere of economic activity has relied heavily and must continue to rely on responsible and effective self-regulation.”¹⁰¹ Self-

⁹⁹ Representative George Hopkins, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24906.

¹⁰⁰ Representative George Hopkins, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24906.

¹⁰¹ Representative George Hopkins, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24906.

regulation was already part of the marketplace. It had led to massive increases in futures trading and wealth creation for people like Melamed (and his clients). No need to alter anything.¹⁰²

This, of course, is a central tenant to free market philosophy. The government, due to political motivations and economic ignorance, could not properly manage the marketplace. Only those who partook in the market would act as regulators because they knew that bad decision making would cost them financially. Capital could regulate itself because capital wants capital to keep growing. According to Hopkins, “In the final analysis, the market provides the only standard that can safely and accurately be applied.” Ignoring the fact that this ideology was put into practice at the end of the nineteenth century, leading to almost the complete destruction of capitalism in 1929, this simple belief was at the root of the Efficient Market theory.

Congressional representatives, like Hopkins, fully supported the idea, and in effect, made the imagined world of laissez faire self-regulation reality by codifying its central ideal.¹⁰³

The proceedings were not completely free of trepidation. Kika De La Garza, a Democrat from Texas and the Chair of the House Agriculture Committee, provided a lengthy overview of the legislation to the chamber. While many of the points were positive, as noted above, De La Garza recognized that “Stock index futures is a controversial development and one which merits close study and oversight which is provided for by H.R. 5447.”¹⁰⁴ Specifically, the “study would monitor a 2-year pilot program of stock index futures trading and a report to Congress is required within 4 months after the expiration of the pilot program. If the report concludes that the adverse effects resulting from stock index futures trading outweigh any benefits, the Commission must

¹⁰² Months before the 1987 Crash, Melamed touted that “the exchanges themselves have been excellent ‘self-regulators.’” See Leo Melamed, “Leo Melamed’s Response to Institutional Investors Global Capital Markets Forum” Press Release, January 8, 1987, [p.1], CME Series 2, Box 66, Folder 6.

¹⁰³ Representative George Hopkins, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24906.

¹⁰⁴ Representative Kika De La Garza, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 14917.

include in the report plans for the orderly withdrawal of approval of all stock index futures contracts.”¹⁰⁵ Despite the whatever sway that Melamed and other financiers had over the Agricultural Committee, the Financial Futures Act of 1982 had some rather sharp teeth.¹⁰⁶ If the legislation fundamentally harmed the economy, all financial futures contracts, like onion contracts before them, would cease to be legal.

The study, published in 1984, found no reason for concern. In fact, it argued just the opposite—financial futures were economically necessary.¹⁰⁷ The study focused on two key uses of financial futures: price discovery and facilitating liquidity. Price discovery had long been central to futures contracts. As noted earlier, wheat futures essentially brought global buyers and sellers of the commodity to the same market in Chicago, which created a globally agreed upon price for stacks of wheat on any given day. Or, as the study put it:

A futures contract specifies a homogeneous variety of product and designates a unique delivery date for settlement.... By centralizing order flow to a unique location—the pit on the floor of a futures exchange—a single price emerges for the variety of the product specified in the futures contract.... Thus, a single price emerges for gold, silver, wheat, and corn (all highly storable commodities) as well as for Treasury bonds, Treasury notes, and certificates of

¹⁰⁵ Representative Kika De La Garza, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 14919.

¹⁰⁶ De La Garza and other members of the Agricultural and Banking Committees were specifically targeted by Melamed’s CME with the “goal . . . to have positive pieces published in lead publications in their districts” as a form of soft-lobbying. See “Memo of November 17, 1986, Subject Program Trading Congressional Program,” CME Series 2, Box 60, Folder 1.

¹⁰⁷ “A Study of the Effects on the Economy of Trading in Futures Options,” Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission, and the Securities and Exchange Commission (1984), I2. The researchers believed in this argument to such an extent that they named the public publication of their study after it. William L. Silber, “The Economic Role of Financial Futures,” (American Enterprise Institute for Public Policy Research, 1985), 83-112.

deposit (CDs) to replace the multitude of cash market prices quoted for specific items by numerous dealers.

Just as with wheat, futures contracts create a stable price for financial instruments such as Treasury notes or Ginnie Mae contracts. “[B]ecause of the large number of participants in liquid markets, transactions prices more accurately reflect the judgment of all potential traders, bringing transactions prices closer to true equilibrium prices compared with less liquid markets.”¹⁰⁸ This then creates market confidence in the trading price, facilitating investment and exchange. Speculation is what it had always been—a means to spur investment into the economy, creating economic growth.¹⁰⁹

Generating liquidity investment is not a small feature. Although by 1983 the so-called Reagan Recovery had begun, fears of continued stagflation still hung thick in the air. Congress sought to encourage investment in order to keep capital flowing by numerous means. Again, this is a key point of Reagan’s Tax Cuts and the Democratic-led Tax Reform Act of 1986. Financial futures were yet another strategy to increase liquidity: “Perhaps the most important outcome of the standardization of contract terms in futures markets is the liquidity that emerges as a result of the increased participation of hedgers and speculators in the marketplace.”¹¹⁰ Price discovery and creating a single market creates “the ability to transact quickly without unduly influencing price” which then increases trading volume. This was argued as beneficial for the economy because “Most evidence shows that liquidity is positively related to the volume of trading.”¹¹¹ Increased trade volume creates liquidity in the market, which eventually translates into wealth generation.

¹⁰⁸ Silber, “The Economic Role of Financial Futures,” 90.

¹⁰⁹ Silber, “The Economic Role of Financial Futures,” 89.

¹¹⁰ Silber, “The Economic Role of Financial Futures,” 90.

¹¹¹ Silber, “The Economic Role of Financial Futures,” 90.

This dynamic is, of course, central to the Reagan Recovery. Wall Street trading underpinned the entire recovery, adding proof to the study's findings that

the liquidity provided by financial markets clearly adds to economic welfare by reducing the cost of capital to potential real investments, with the associated benefits for capital formation. ... Since the major contribution of financial futures is an improvement in the liquidity of financial markets, one can conclude that financial futures add to real investment and capital formation.¹¹²

A rising financial market meant economic growth. According to supply-side theorists, this growth would eventually lead to investments back into the American economy, creating lower unemployment and equitable wealth.¹¹³

By the mid-1970s, traders like Leo Melamed were making huge sums of money speculating on the future price of index funds. Despite the success of early financial futures, key questions surrounding their larger economic role cast doubt if the practice should be legal. The debate surrounding, and speedy passage of, the Financial Futures Act of 1982 succinctly answered these questions. Speculation, once recognized as “a very dirty word,” was now central and necessary.¹¹⁴ Congress fundamentally transformed the law surrounding futures contracts by ending the concept of “contemplating delivery” for “cash settlement,” to ensure that the growing financial market remained legal and robust in the U.S. As the Reagan Recovery gained steam, wealth creation by people like Melamed was seen as not only necessary, but virtuous.

¹¹² Silber, “The Economic Role of Financial Futures,” 98.

¹¹³ Michael J. Boskin, “Taxation, Saving, and the Rate of Interest,” *Journal of Political Economy* 86, no. 2, Part 2 (April 1978): S3–27.

¹¹⁴ Leo Melamed, “The International Monetary Market of the Chicago Mercantile Exchange” Speech, Nov 27, 1974, CME Series 2, Box 66, Folder 2.

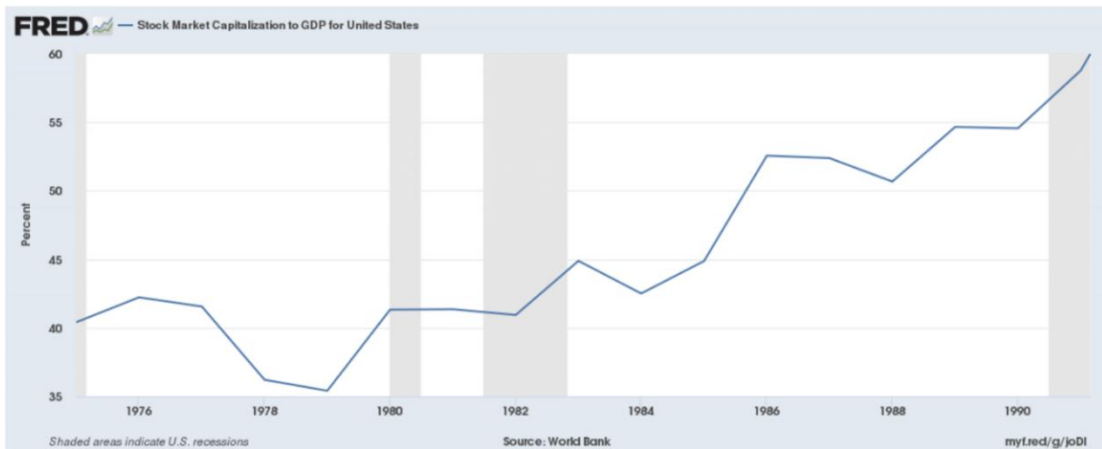


Figure 4. Stock Market Capitalization to GDP for the United States¹¹⁵

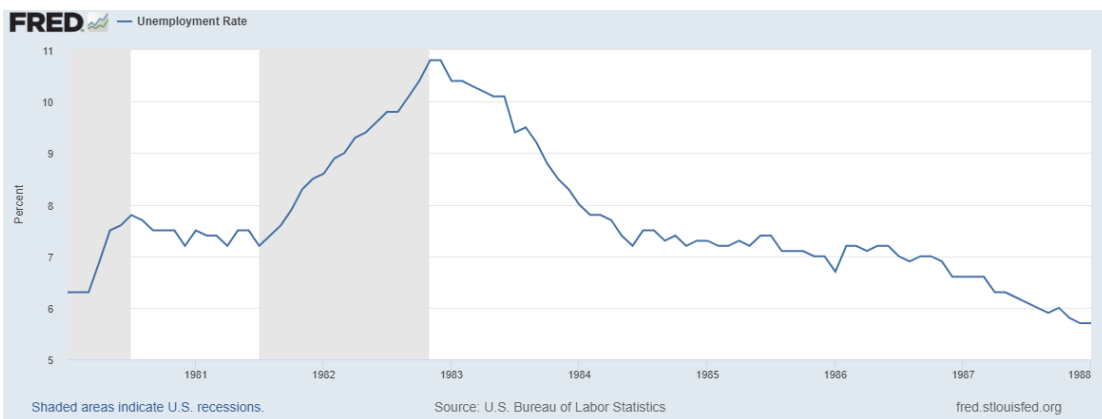


Figure 5. Unemployment After Double-Dip Recession. Continued downward trend throughout Reagan’s Presidency¹¹⁶

The charts above seem to support this rather rosy picture of the effect of financialization on the economy. As GDP grew, unemployment decreased, creating a new era of abundance for Americans. However, this economy worked for fewer and fewer Americans. Recall the circumstances surrounding the Tax Reform Act of 1986. Industrial plant closings grew throughout the decade, leaving swaths of the country rusting in poverty. The corresponding rise

¹¹⁵ Federal Reserve Bank of St. Louis, “Stock Market Capitalization to GDP for United States, 1975-1992,” Fred.stlouisfed.org, last visited March 21, 2023, <https://fred.stlouisfed.org/series/DDDM01USA156NWDB#>.

¹¹⁶ Federal Reserve Bank of St. Louis, “Unemployment Rate, 1980-1988,” Fred.stlouisfed.org, last visited March 21, 2023, <https://fred.stlouisfed.org/series/UNRATE#>.

in service work, especially caregivers who attended to the aging bodies of the men who once filled the ranks of industrial production, remained low paying and unprotected by the state.¹¹⁷

Meanwhile, men such as Melamed paid less in taxes in hopes of spurring domestic investment. A rising economic tide did not raise all ships as the service industry became bifurcated between those who produced astronomical economic growth on paper—such as financial traders—and those who attended to day-to-day needs in retail, food, and healthcare. Productivity climbed as wages flatlined. Broad growth requires a strong hand, specifically one of the federal government, to support institutions such as unions to redistribute wealth downward through wages, or policies of direct investment in the vein of subsidized higher education to alleviate rising cost of living. The Reagan Revolution turned these cornerstones of the New Deal into malevolent ideals. The free market, and only the free market, could be used to improve society. Never mind the federal government’s continued active role in creating and supporting business and finance through tax policy and rewriting long-established laws.

There is, however, a silver lining in all this. Financialization can be seen as progress in that the U.S. economy was no longer centered heavy industry that polluted the environment and destroyed the bodies of laborers. However, the transformation was only half done. New wealth was generated, but not distributed downward through the broader economy, causing a wealth disparity that has grown to crisis levels seen today.

¹¹⁷ Gabriel Winant, *The Next Shift: The Fall of Industry and the Rise of Health Care in Rust Belt America* (Harvard University Press, 2021).

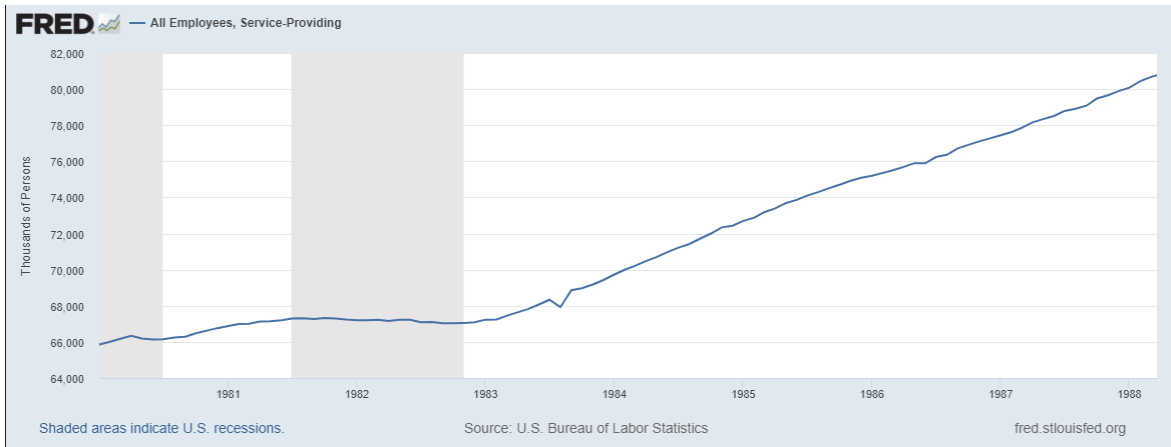
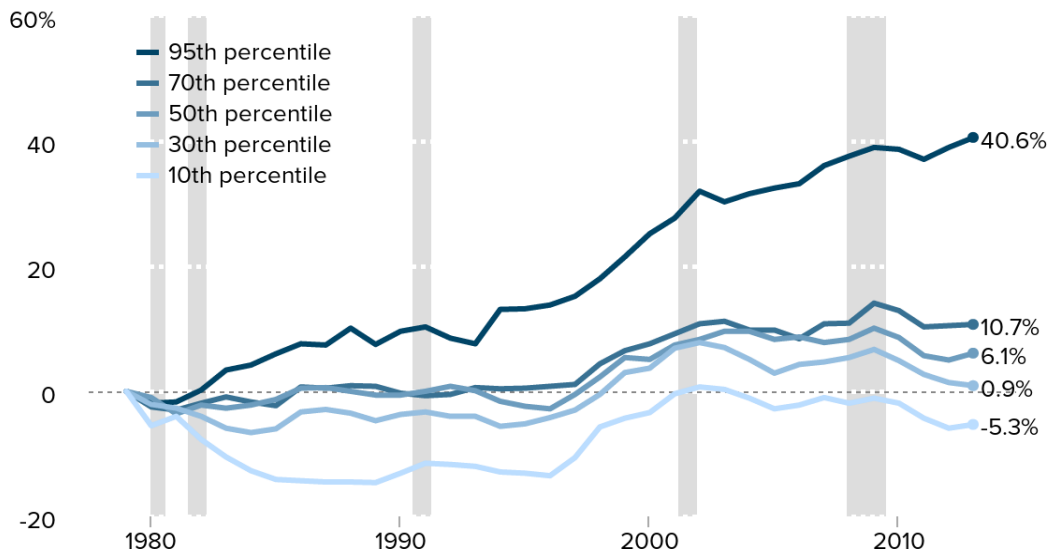


Figure 6. Rise of Service Sector Employment¹¹⁸

Cumulative change in real hourly wages of all workers, by wage percentile,* 1979–2013



* The xth-percentile wage is the wage at which x% of wage earners earn less and (100-x)% earn more.

Note: Shaded areas denote recessions.

Source: EPI analysis of Current Population Survey Outgoing Rotation Group microdata

Economic Policy Institute

Figure 7. Rising Inequality Since 1980¹¹⁹

¹¹⁸ Federal Reserve Bank of St. Louis, “All Employees, Service-Providing,” Fred.stlouisfed.org, last visited March 21, 2023, <https://fred.stlouisfed.org/series/SRVPRD>.

¹¹⁹ Lawrence Mishel, Elise Gould, and Josh Bivens, “Wage Stagnation in Nine Charts,” Economic Policy Institute, January 6, 2015, last visited June 12, 2023, <https://www.epi.org/publication/charting-wage-stagnation/>.

The financialization of the U.S. economy cannot be reduced to a single act, reform, or policy change. Rather, fundamental changes wrought by the Volcker Shock rippled through the American (and global) economy, spurring unexpected outcomes throughout the 1980s. Futures exchanges were one of many areas of the economy that transformed. Radical and subtle changes of the futures marketplace, from cash settlement to the transition to non-agricultural commodities, created an economic world very different from the industrial-based model that had dominated for two centuries. Crafty financiers introduced new products made possible by the fracturing of the old New Deal Order. Congress supported these changes to end the economic chaos that had dominated throughout the previous decade.¹²⁰

Although there was no great “neoliberal masterplan” to transform the political economy, the many changes that occurred during this period became a type of conventional wisdom. Legislation related to financial futures encapsulates this model. After 1982, congressional and executive support for the industry only grew. Each subsequent renewal of the CFTC and corresponding updates to the Financial Futures Act gave traders such as Leo Melamed more leeway to expand the derivative market.¹²¹ By the turn of the century, the market was almost completely unregulated. The Commodity Futures Modernization Act of 2000 (CFMA), signed by Bill Clinton in 2000, allowed credit default swaps, lifted the ban on trading futures on single stocks, reduced collateral for futures contracts, decreased scrutiny in “over the counter” derivative products, and included the “Enron loophole” that completely exempted over the counter energy trades on electricity from government regulation.¹²²

¹²⁰ Daniel Rodgers, *Age of Fracture* (Harvard University Press, 2011).

¹²¹ CFMA continued an existing 1992 preemption of state laws enacted in the Futures Trading Practices Act of 1992.

¹²² U.S. Congress, House, *Commodity Futures Modernization Act of 2000*, HR 5660, 106th Cong., 2d sess., December 21, 2000.

Shock and bust followed. First with the bankruptcy of Enron in 2001, then the U.S. housing market, and world economy in 2008. For many, the Great Recession seemed to appear out of thin air. We now can trace a direct line from the actions of traders like Leo Melamed and congressional legislation to the collapse of Lehman Brothers. However, there were signs of instability almost immediately. In 1987, Wall Street experienced a panic that resulted in losses exceeding those of 1929. A congressional investigation revealed the structural fragility at the heart of the new financial economy. Congress was then faced with a choice: regulate and reassert control over the new producers of the American economy and risk limiting, or even losing, their economic production, or support the financial industry, no matter the cost.

Chapter 5

The Crash of 1987 and The Golden Egg of Financial Production

“We are looking down the barrel, and the gun is still loaded.” Nicholas Brady, the chairman of President Reagan’s Task Force on Market Mechanisms, did not mince words. On October 19, 1987—Black Monday—the stock market experienced a sudden and severe crash, exceeding the losses of 1929. Testifying before Congress, Brady declared that “We must act to prevent a recurrence of the events of October.” Only through “changes in existing laws” could another calamity be avoided. If not, another crash, far more disastrous, was sure to follow. The gun was loaded and pointed directly at the American economy. Congress simply needed to remove the shells by further regulating the Chicago futures market.¹

Leo Melamed, the former Chairman of the Chicago Mercantile Exchange (CME), agreed with Brady. There was a shotgun aimed at the American economy. According to Melamed, the threat came from “those voodoo economics which transformed this prosperous nation from a creditor to a debtor for the first time in our history. Those voodoo economics which turned our financial fabric upside down, creating a monumental trade gap with all our trading partners, a record low value for the dollar, high interest rate prospects, higher inflationary expectations”² This is a rather surprising sentiment. As we learned in the previous chapter, Melamed was an ardent supporter of the free market. Yet, two months after the Crash of 1987 he deemed

¹ U.S. Congress, Senate, Committee on Banking, Housing, and Urban Affairs, *The Turbulence in the Financial Markets Last October, the Functioning of our Financial Markets During that Period, and Proposals for Structural and Regulatory Reforms: Hearings before the Committee on Banking, Housing, and Urban Affairs*, 100th Cong., 2nd sess., February 2, 3, 4, and 5, 1988, Chairman of the Presidential Task Force on Market Mechanisms Nicholas Brady, 39.

² Leo Melamed, “Who Killed Cock Robin?,” Speech Presented at the American Bar Association Committee on Futures Regulation, Acapulco, Mexico, January 23, 1988, University of Illinois Chicago Special Collections (Richard J. Daley Library), Chicago Mercantile Exchange records [hereinafter CME], Series 2, Box 66, Folder 6, p.1.

“voodoo economics”—the term George H.W. Bush used to describe Reagan’s free market ethos in 1980—as the main threat to the economy.³

In a speech directly responding to Brady’s proposed regulation of the futures market, Melamed clarified his position. Voodoo economics was not necessarily the same as the free market, but rather an ethos that supported “all those silly people who believed that the tulip-mania of the 1980s would never end—that the stock market would go up forever—that economics had nothing to do with it—that the Dow was going to 3600 and that everyone would get out at the top or at least before it crested!”⁴ The voodoo was pure speculation that, in fact, ignored market principles.

Melamed outlined a subtle critique of what led to the Crash of 1987. Speculation had created unprecedented growth, but after “this stock market mania [came] crashing down around our ears, [did] we blame our own stupidity and greed? Don’t be silly. We ran about looking for the real culprit who did this. We demand an investigation. Who killed Cock Robin? Let’s lynch the son-of-a-gun. Let’s have some hearings—let’s have some studies.”⁵ Where Brady found a solution—Congress must regulate the futures market—Melamed found a scapegoat: “It’s the Chicago pits. They are evil, they are dens of speculation, purposeless and immoral. They immediately ought to be done away with—and should be moved to New York.”⁶ The futures market, according to Melamed, did not cause the crash. It was the result of the same dynamics that led to every financial collapse. The futures market, in fact, acted virtuously by signaling to the world that the market had far outpaced real growth and devolved into pure speculation. The

³ “1980 Republican Presidential Candidates Debate,” C-SPAN video, 57:18, April 23, 1980, <https://www.c-span.org/video/?407380-1/1980-republican-presidential-candidates-debate>.

⁴ Melamed, “Who Killed Cock Robin?,” Speech Presented at the American Bar Association Committee on Futures Regulation, Acapulco, Mexico, January 23, 1988, CME Series 2, Box 66, Folder 6, p.2.

⁵ Melamed, “Who Killed Cock Robin?,” Speech Presented at the American Bar Association Committee on Futures Regulation, Acapulco, Mexico, January 23, 1988, CME Series 2, Box 66, Folder 6, p.2.

⁶ Melamed, “Who Killed Cock Robin?,” Speech Presented at the American Bar Association Committee on Futures Regulation, Acapulco, Mexico, January 23, 1988, CME Series 2, Box 66, Folder 6, p.2.

crash did not emanate from the Chicago markets, they merely foretold of its coming. Regulating the Chicago exchanges would not “remove the shells” of the gun, but merely point it at the messenger and let fire.

The contention between Brady and Melamed speaks to the heart of the contradiction and confusion of financial production. The Crash of 1987 began an epoch where the market would boom and bust over the next four decades, leading to the Financial Crisis of 2007/8 and resulting Great Recession. How best could this new production be controlled, if it could be at all? According to Brady, Congress must do its part with more overt government regulation. Melamed countered, arguing that the futures market virtuously and admirably performed its role as a signal to the world that the animal spirits had taken control. Regulation would only stymie domestic economic growth and eventually cause the financial markets to move to new centers abroad. If the financial markets, especially the Chicago futures exchanges, were regulated, the rust of manufacturing would spread to finance.

The Crash of 1987 represents the full formation of financialized production. The forces that led to the crash, and the lack of legislative response, occurred again in the early 2000s, and of course in 2008. Each time rabid speculation created a commodity bubble that finally burst, bringing economic destruction in its wake. Each time the Federal Reserve worked to save the market. Each time the federal government failed to fully address flaws in the financial marketplace.⁷

By 1987, financiers such as Melamed had become the virtuous producers of the American economy. At the center of their world was the “ultimate commodity”—the New York

⁷ Adam Tooze, *Crashed: How a Decade of Financial Crises Changed the World* (Viking, 2018); John Cassidy, *Dot.com: How America Lost Its Mind and Money in the Internet Era* (HarperCollins, 2002).

Stock Exchange. Much like the forces that created the Farm Crisis, the center of the U.S. economy can be understood as a commodity bubble. The New York Stock Exchange (NYSE)—measured in various ways as explored in the previous chapter—generated the wealth of the nation. Financiers must be supported, much like farmers, lest the market move to another nation, leaving the U.S. in a malaise of a post-financial future.

In order to fully understand this claim, we must closely scrutinize the dynamics that led to Black Monday. As we have seen in previous chapters, the “Reagan Recovery” created rapid wealth creation. Though efforts to reign paper entrepreneurialism were somewhat successful by the New Democrats’ Tax Reform Act of 1986, financial profits continued to grow. Foreign capital, domestic savings, and corporate profits all found their way into America’s financial market. According to Melamed, “These enormous money flows ignored basic economics and it was almost like a wave that couldn’t be stopped and kept going higher and higher.”⁸ This created a euphoria among traders who began to ignore fundamental market practices and instead listened to their “animal spirits.”⁹ Rising market values attracted more investment, which drove up value, which in turn attracted more investment, which in turn further drove up value. Even Melamed’s own CME celebrated the ever-growing market as press release after press release celebrated new all-time highs on the exchange.¹⁰ As Alan Greenspan testified, “The bull market from 1982 onward was nurtured by a favorable economic setting for businesses which investors came increasingly to view as likely to be sustained . . . In essence, there was an illusion of liquidity

⁸ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Leo Melamed, 280.

⁹ John Maynard Keynes, *The General Theory of Employment, Interest, and Money* (Harcourt, Inc., 1964, 1991), 161.

¹⁰ See, for example, “Memo: Trading Volume in S&P Options Reaches All-Time Weekly High,” CME Series 2, Box 6, Folder 1.

that likely encourage larger equity positions on the part of many investors.”¹¹ This would be the fuel to the fire.

But it is not enough to simply have financial growth. What, specifically, caused the NYSE to turn into a commodity bubble? For that we must understand how the developments of financial futures—specifically the S&P500—combined with a strategy known as portfolio insurance. To insure against financialized risk, this strategy effectively tethered Chicago’s speculative futures to New York’s stocks through the process of arbitration. Much like we saw in the Savings & Loan Crisis, what were once discreet marketplaces became one, allowing for greater profits, but also greater risk of interconnected collapse. This connection created a feedback loop that exacerbated both gains and losses.

The key players in the is dynamic are exactly who you would think they would be. Large investment banks and hedge funds such as Goldman Sachs and Soloman Brothers. Their concentrated wealth, combined with the structure of portfolio insurance, created a “herding” dynamic that quickly destabilized the entire financial marketplace. However, these institutions do not only represent the wealth of millionaires and billionaires. In fact, most of the money involved came from pension funds, municipalities, and other forms of savings from everyday Americans. In an ironic twist of fate, the financialization of the U.S. economy was partly funded by the savings of American labor. This wealth added amplitude to the feedback loop, creating record gains, but also the volatility on full display in October of 1987.

The basis for financial futures, portfolio insurance, and many other financial strategies was the ideal of self-regulation. Financial managers were given wide leverage to create and invest in new financial products because rational self-preservation would prevent excessive

¹¹ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Alan Greenspan, 84-85.

speculation. After all, no financier would willingly gamble away their funds in an obvious overvalued market, right? Yet, this is exactly what happened. The actors of the marketplace—humans who initiated and executed trades—did not act rationally. The financial marketplace was growing faster than any metric would predict. The underlying values of the companies represented by the S&P500 were not increasing as fast as the stock value denoted. There was no real reason for this rapid financial expansion beyond the motivation for quick profits. Speculation became the rationality.

The ideas explored in the previous four chapters came together in October 1987. The effects of Reagan's and New Democrats' tax reforms helped funnel, and then curb, investment in the financial marketplace. Markets once thought as wholly separate were connected through investment. The nation finally became one highly liquid marketplace, with profitable opportunities in empty buildings and, thanks to the work of men like Melamed, the stock market itself. New financial products fueled speculation—not unlike the American farmland—in the new commodity of the NYSE. Speculation became rationalized and investment poured into Chicago and New York financial markets with no real coherent reason. Finally, the bubble burst and the Federal Reserve bailed out the new virtuous producers of American wealth.

“How do you prepare for a bloodbath?”¹² That is how Chicago futures trader, Kenny Polcari, described October 19, 1987. On that day alone, “the Dow fell by 508 points or 22.6 percent,” representing the largest one-day percentage drop in U.S. history.¹³ Although Monday the 19th would be deemed “Black Monday,” it was only one day of nearly a week of chaos.

¹² “Remembering Black Monday, a Day of ‘Utter Devastation’ on Wall Street,” WNYC Crash Course, 1:57, October 18, 2017, <https://www.youtube.com/watch?v=xY8gW0snprg&t=1s>.

¹³ Presidential Task Force on Market Mechanisms, *Report of Presidential Task Force on Market Mechanisms*, Nicholas F. Brady Chairman, James C. Cotting, Robert G. Kirby, John, R. Opel, and Howard M. Stein Washington, D.C., GPO, 1988, 1 [hereinafter Brady Commission Report].

“From the close of trading on Tuesday October 13, 1987 to the close of trading on October 19, 1987, the Dow Jones Industrial Average (Dow) fell 769 points or 31 percent. . . . In those four days of trading, the value of all outstanding U.S. stocks decreased by almost \$1.0 trillion.”¹⁴ Not to be outdone, the S&P 500 lost 58 points, or 30 percent of its value.¹⁵ In four days, the unprecedented gains made during 1986 nearly vanished. To put it in perspective, “since the early 1920’s, only the drop of 12.8 percent in the Dow on October 28, 1929 and fall of 11.7 percent the following day, which together constituted the Crash of 1929, have approached the October 19 decline and magnitude.”¹⁶

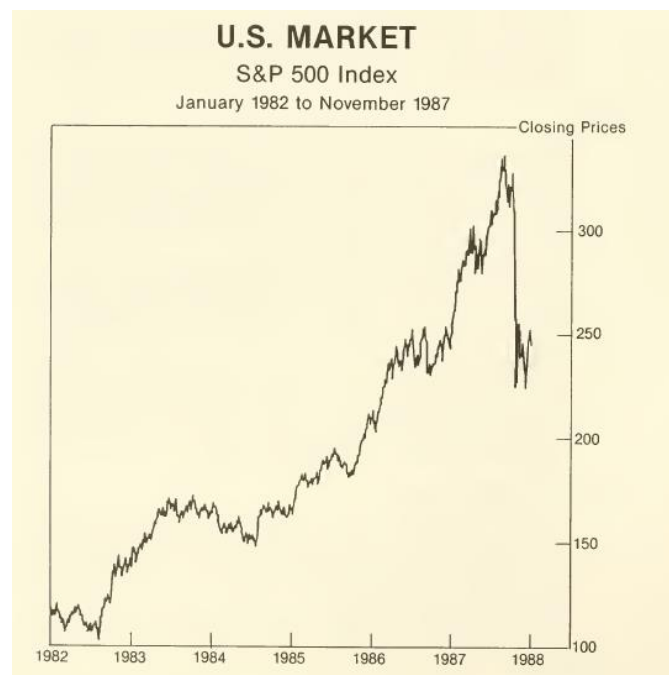


Figure 8. Brady Commission Report: S&P 500 Index, p.10

What caused this calamity? There was no clear reason why, specifically, in late October the market suddenly crashed. However, The Chicago Mercantile Exchange and Chicago Board of Trade agreed with the Presidential Task Force, headed by former senator and future Treasury

¹⁴ Brady Commission Report, 1.

¹⁵ Russell O. Wright, *Chronology of the Stock Market* (Jefferson, NC: McFarland, 2002), 70.

¹⁶ Joanne M. Hill, “Commentary on the October 1987 Market Crash,” The Financial Futures Department Kidder, Peabody & Co., 1988, University of Illinois Chicago Special Collections (Richard J. Daley Library), Chicago Board of Trade records, Part 2, 1893-2006 [hereinafter CBOT], Series 3, Box 15, Folder 11; Brady Commission Report, 1.

Secretary, Nicholas Brady, that the “precipitous market decline of mid-October was ‘triggered’ by specific events.” First, “the government announced that the merchandise trade deficit for August was \$15.7 billion,” approximately \$1.5 billion above the expected figure. This trade deficit caused traders in the foreign exchange markets—Melamed’s currency futures markets explored in the last chapter—to sell dollars, believing that the value of the dollar would fall in order to counter the increasing trade deficit. This sell-off created more selling by two important groups: mutual funds and portfolio insurers. I will closely analyze what exactly these two entities are in the pages ahead. For now, it is important to understand that they represent a massive amount of investment capital, thus, according to Brady, “a limited number of investors played the dominant role during this tumultuous period.” Concentrated wealth drove the market to panic.¹⁷

Rumor also helped ignite the spark. Specifically, the House Ways and Means Committee announced that they were going to file legislation to eliminate tax benefits associated with the financing of corporate takeovers. The easy financing that had led to the merger / hostile takeover movement of the 1980s—another example of Robert Reich’s paper entrepreneurialism—was set to end.¹⁸ As Brady explains, “As risk arbitrageurs came to appreciate the seriousness of the legislative initiative, they began to liquidate their positions, collapsing prices of takeover shares. These stocks had led the bull market up and now, during the week of October 14 to October 20,

¹⁷ Brady Commission Report, 15. Leo Melamed echoed the Brady Commission Report findings, adding “psychological concerns [such as] an unsettling Persian Gulf situation . . . dire predictions about inflation . . . a falling dollar” to the storm of malady that scared investors. *See* Leo Melamed, “Special Report: Embracing Reality,” *in* “1988: Market Dynamics Realign,” January, 1988, CME Series 1, Box 2, Folder 4, p.12; The Chicago Board of Trade furthered these claims in their official after-crash report: “October 1987 Stock Market Crash,” “Performance Statement” and “Executive Summary” January 1988, CBOT Part 2, Series 3, Box 15, Folder 9.

¹⁸ Melamed, “Special Report: Embracing Reality,” *in* “1988: Market Dynamics Realign,” January, 1988, CME Series 1, Box 2, Folder 4, p.12.

they would begin to lead it back down again.” Speculation caused by easy financing had led to market gains. Once that spigot was thought to close, investment sought returns elsewhere.¹⁹

Declining prices did not remain in the Chicago market. The massive sell off “in the futures market was transmitted to the stock market by the mechanism of index arbitrage.” Thus, both the futures market in Chicago and the NYSE were in sell modes, creating the seismic drop in prices shown in the graphs above.²⁰

The chain reaction that led to the market break is relatively straight forward. Futures traders sensed an end to both easy financing and the value of the dollar, causing them to sell. Their selling soon transferred to the NYSE, causing a rapid decline in prices as more and more investors tried to sell in a market with no buyers. However, there is much to unpack. In the pages ahead, we will discover just how the financial strategies and products of portfolio insurance, index funds, and arbitration, and their role in the crash, represented the new financialized production, rather than a mirroring previous financial busts.

For Polcari and his fellow futures traders, October 19th felt “like the end of the world.”²¹ But it was not. As shown in the Federal Reserve timeline below, various entities coordinated through the crash to help stabilize the market.²² Specifically, after the dramatic loss of October 19th, NYSE president, John Phelan, coordinated with Leo Melamed of the Chicago Mercantile Exchange to limit, suspend, and then slowly allow trading to ensure market stability.²³ According to Melamed, the actions of both men “show[ed] Congress for the first time that the exchanges

¹⁹ Brady Commission Report, 15.

²⁰ Brady Commission Report, 1, 15.

²¹ “Remembering Black Monday,” WYNC, <https://www.youtube.com/watch?v=xY8gW0snprg&t=1s>.

²² For an extensive overview of the collapse, *see*, Diana B. Henriques, *A First-Class Catastrophe: The Road to Black Monday, The Worst Day in Wall Street History* (Henry Holt and Company, 2017); Tim Metz, *Black Monday: The Catastrophe of October 19, 1987 ... And Beyond* (William Morrow and Company, Inc., 1988).

²³ “CME Takes Emergency Actions; Reduces S&P Hours; Imposes Price Limits,” Press Release October 22, 1987, CME Series 2, Box 53, Folder 4; Steve Coll and David A. Vice, “Stock Futures Market Is Flexing Its Muscle: Since October 19, Merc Has Fought Reform,” *Washington Post* October 16, 1988, 1; Back to the Futures 381.

could work toward a solution on their own.” This bolstered their belief that “the exchanges [CME & NYSE] themselves have been excellent self-regulators in the months leading up to, and through Black Monday.”²⁴ Thus, “Under no circumstances did either of us want government intrusion into the marketplace.”²⁵

This point, however, is muted by Melamed’s own words about the role of the Federal Reserve: “There is no mystery about it. The Federal Reserve’s release of liquidity to the market and the corporate buy-back of stock, combined with an exhaustion of panic selling, turned the situation around on Tuesday.”²⁶ On Tuesday, October 29th, Federal Reserve Chair Alan Greenspan stated “that consistent with its responsibilities as the Nation’s central bank, affirmed its readiness to serve as a source of liquidity to support the economic and financial system”²⁷ The Fed began to use its reserves to add liquidity into the stalling market. In twelve hours, the Fed had purchased nearly \$17 billion—seven percent of the monetary base for the entire U.S.—through the open market. Suddenly the biggest buyer in the world, the Federal Reserve, appeared in a market where hours before there were none. Greenspan’s tactic was successful; confidence returned, stabilizing the free fall by the next day.²⁸ The market then continued to grow steadily until the recession of 1991, the official end of the Reagan Recovery.

²⁴ Leo Melamed, “Leo Melamed’s Response to Institutional Investors Global Capital Markets Forum,” Interview, January 8, 1987, CME Series 2, Box 66, Folder 6.

²⁵ Steve Coll and David A. Vice, “Stock Futures Market Is Flexing Its Muscle: Since October 19, Merc Has Fought Reform,” *Washington Post* October 16, 1988, 1; Back to the Futures 381.

²⁶ *Back to the Futures*, 370-71.

²⁷ Alan Greenspan, “Announcement by Chairman Greenspan on the availability of liquidity to the financial system,” *Federal Reserve Bulletin*, Vol. 73, No. 12, December 1987, 914.

²⁸ Michael Mussa, “*Monetary Policy: Michael Mussa*” in Feldstein, Martin S. (ed.). *American Economic Policy in the 1980s* (University of Chicago Press, 1995), 128.

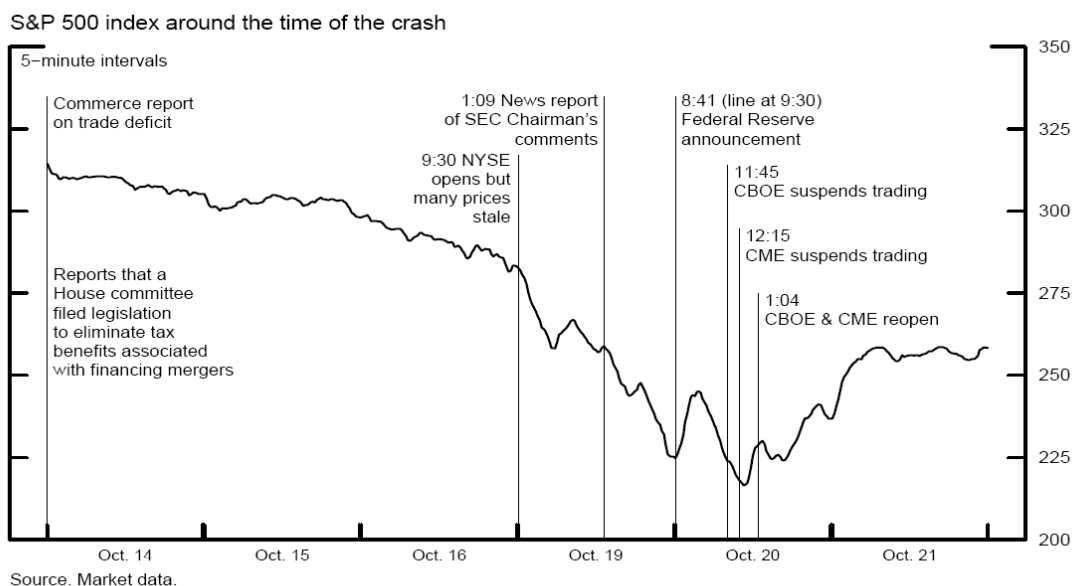


Figure 9. Mark Carlson, “A Brief History of the 1987 Stock Market Crash with a Discussion of the Federal Reserve Response,” Finance and Economics Discussion Series Divisions of Research & Statistics and Monetary Affairs Federal Reserve Board. Washington, D.C., November, 2006, 6, <http://www.federalreserve.gov/Pubs/feds/2007/200713/200713pap.pdf>

This is how the crash of 1987 is understood. A footnote at the beginning of nearly four decades of growth in the financial marketplace. However, the events leading up to, and through, Black Monday are not a side note to the country’s political economic history. Rather, the crash encapsulates exactly how the nation’s political economy has worked since the Volcker Shock. Mechanisms intrinsic to the financial world led to a boom-and-bust cycle—a commodity bubble and collapse, again and again and again. The Federal Reserve continues to play its role to put the pieces back together through massive infusions of capital. And, most importantly, Congressional hearings and debates illuminate why legislative inaction is necessary to preserve the place of the U.S. at the heart of the global economy by supporting the new virtuous producer of American society. To understand all of this, we must first investigate how, exactly, did the market begin to reach such heights through the 1980s.

William Proxmire (D Wisc), Chairman of the Senate Committee on Banking, Housing, and Urban Affairs, began the congressional proceedings investigating Black Monday with what he described as the “fundamental conclusion of the Brady report itself.” That is, “from an economic viewpoint, what have been traditionally seen as separate markets, the market for stocks, stock index futures, and stock options, are in fact one market.” This is not the first time that a creation of one fluid market resulted in economic turmoil. As described in chapter three, the deregulatory aspects behind the Garn-St. Germain bill eroded New Deal era mechanisms that siloed investment in mortgages for single-family homes from other markets. The direct connection between the Savings & Loan market with other highly speculative endeavors and the NYSE essentially made mortgages and housing a type of liquid capital that fueled quick get-rich schemes and eventually led to the S&L Crisis.²⁹

Again, like the S&L Crisis, the creation of a fluid and highly speculative market place through legislative action was not done purposefully. In fact, quite the opposite. As we learned in the previous chapter, the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) brokered a deal, the Shad-Johnson Accord, that created a clear boundary between the two agencies’ jurisdiction over derivatives, thus allowing financial futures to trade on the marketplace without ongoing disputes. This agreement was rooted in the fact that the “commodity” of financial futures was wholly separate from the equities of corporate stocks. Thus, the CFTC would regulate the Chicago market, and the SEC would regulate the NYSE. Senator Proxmire recalled this agreement, stating that the “SEC and CFTC predecessors came before this committee in 1981 to help us work out who should oversee the financial futures

²⁹ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Senator William Proxmire, 13; Brady Commission Report, 55.

market.” The Shad-Johnson Accord was codified because, “at the time, the CFTC chairman stressed that the fledgling financial futures products were distinct from equities; they were moved by general economic factors and unconnected to the factors that affected the stock market.” Black Monday had proved that “this viewpoint cannot be defended. Futures and equities markets are linked.” The disaster of 1987 demonstrated that “the facts of financial life are that we have a single financial market; that market demands better coordinated regulation.”³⁰

How did Chicago and New York, understood as two separate markets by the experts at the CFTC and SEC, become one? The answer lies in a strategy known as arbitration. At its core, arbitration is a rather simple tactic that has been used since there have been markets. An arbitrator, or “arb,” finds a price discrepancy between two markets in order to turn a profit. Say, for example, oranges are selling for 20 cents apiece at one market, while at another for 15 cents. An arb would buy a bushel for 15 cents and sell at the higher price, pocketing the 5-cent difference. Though this may seem like a cheap game of manipulation, arbitration serves a distinct economic purpose. By selling between two markets, arbs eventually create price stability, where one price for oranges is “discovered” and agreed upon by an ever-larger share of the population.³¹

Two years after the Financial Futures Act of 1982, this practice had become an everyday strategy on the CME. Instead of oranges, CME traders dealt in the S&P 500 index. As explored in the previous chapter, index funds are a financial product that is composed of a “basket” of underlying stocks that aim to measure the entire marketplace—in this case, the stocks that make up the S&P 500. The CME arbs would seek out discrepancies between the two markets with a basket of S&P 500 stocks in New York, and an analogous holding of S&P 500 futures in

³⁰ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Senator William Proxmire, 129.

³¹ N. Gregory Mankiw, *Principles of Economics*, Seventh Ed. (Cengage Learning, 2015), 315.

Chicago. As Melamed testified before Congress, “index arbitrage works by virtue of the fact that if the stock index futures market is at discount [less] or premium [more] to the actual cash price in the stock market, index arbitrageurs bring both markets into line.”³² Because the price difference between a future index of S&P holdings and the actual stock price in New York fluctuated constantly, an index arbitrator can turn a quick profit by selling futures at a higher price in the CME and buy a basket of stocks at a lower price on the NYSE, or vice versa. Just like the oranges, the two markets would converge on a single price.³³

None of this is not very surprising. After all, arbitration has been around for millennia. So, what was the key difference between trading between the CME and NYSE and buying and selling oranges? There was no limitation as to where oranges could be bought and sold. However, futures markets are structured so that only one exchange can trade in a specific future. Again, as we learned in the last chapter, the CME was the only exchange that dealt in the future index for the S&P 500. And, of course, the NYSE was the only exchange where one could purchase S&P 500 stock. The constant trading between two markets, and only these two markets, effectively connected Chicago and New York into one financial marketplace where the future and current price of the S&P 500 bundle could be traded. By 1986, New York and Chicago were so interconnected as to warrant a Joint Task Force to formalize the “trading link between the two markets,” led by Leo Melamed.³⁴

The dynamic between the CME’s future exchange and the NYSE wrought questions of the morality behind the entire financial marketplace. Republican Senator Alfonse D’Amato of New York questioned Brady: “Have we gotten into a business where we really are gambling?”

³² U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Leo Melamed, 281.

³³ Metz, *Black Monday*, 16, 72.

³⁴ “New York Stock Exchange and Chicago Mercantile Exchange Form Joint Task Force; will explore Establishment of Trading Link,” Press Release, April, 1986, CME Series 2, Box 43, Folder 8. Arbitration was not recognized as a “formal” connection.

Have we made this a casino”³⁵ The historic distrust of the highly speculative nature of the Chicago futures market, combined with the monopoly access to the NYSE, seemed to create a marketplace ripe for manipulation. After all, arbitrators had their hands on both ends of the scale. What prevented them from artificially driving up the value of a future or a stock bundle in order to profit from the price discrepancy, with no real economic value created? Brady, in response, attempted to assuage D’Amato’s fears. Volatility caused by the arbitrators were part of “symptoms rather than root causes” of the collapse. There was no real conspiracy to remake the financial markets into a casino. Rather, actors within the market recognized a means to profit, and in turn transformed the dynamics of the marketplace.³⁶

However, Brady was not an apologist for financial traders. Until Black Monday, it was thought that “free market forces would take care of [market manipulation].”³⁷ However, the collapse had demonstrated to Brady that more overt government regulation was needed. Self-regulating adjustments after the collapse did not “convince [Brady] that it won’t start up again in some different form. When you have the kind of volatility and kind of volume you have in a market, the structures of which are ill-suited to take care of it, you are going to get leaks in the pipe.”³⁸ Financial traders were merely acting according to the structure of the marketplace. Disparity between prices have long been resolved by arbitration. They were not simple gamblers, but provided a needed service. However, this service needed to be closely monitored by the federal government, according to Brady. Otherwise, wild fluctuations within the market would continue.

³⁵ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Senator Alfonse D’Amato, 47.

³⁶ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Nicholas Brady, 47.

³⁷ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Nicholas Brady, 47.

³⁸ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Nicholas Brady, 47.

Within this exchange, Brady called attention to a key facet that led to Black Monday. “With regard to portfolio insurance . . . I think there should be a much closer look taken at that in light of what happened in October”³⁹ Portfolio insurance specifically, rather than arbitration broadly, was the area of concern for Brady.⁴⁰ Accordingly, regulating this one strategy would help reign in the animal spirits.

What exactly is portfolio insurance, and how did it lead to instability within the Chicago and New York exchanges? Insurance, of course, was not a new concept. Risk is fundamental to capitalism—the unknown future can be both the home of unparalleled gains and destructive losses. Every investment is shadowed by the risk of failure. Insurance grew to hedge against risk. Home insurance protects against an unknown future that may see your house burn down. Health insurance helps guard against unseen ailment. Financial insurance, at its core, operates under the same idea. As we discussed in the previous chapter, the futures market in Chicago acted as a hedge against farm disaster. Farmers, in theory, could purchase futures contracts on wheat that had yet to be grown in order to secure a stable price for their future wheat production.⁴¹

Portfolio insurance was created to hedge against massive losses in the financial sector. The strategy is based upon a rather simple concept that it is fruitful to own more stocks when the market is rising in value, and fewer stocks when it is falling. Executing this strategy is, however, rather complex. How can one investor react to the multiple price fluctuations of Wall Street fast enough to take advantage of rising stocks, while also unloading others to prevent losses? In the late nineteen seventies, two Cal Berkeley professors, Hayne Leland and Mark Rubenstein, used quantitative data and newly available computers to develop a program that could address these

³⁹ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Nicholas Brady, 47.

⁴⁰ Brady Commission Report, 7.

⁴¹ William Cronon, *Nature's Metropolis: Chicago and the Great West* (WW Norton, 1991), Chapter 3 “Pricing the Future: Grain,” 97-147; Jonathan Levy, *Freaks of Fortune: The Emerging World of Capitalism and Risk in America* (Harvard University Press, 2012), Chapter 7, “Trading the Future,” 231-63.

issues. By the early 1980s, the two professors started a company, Leland O'Brien Rubenstein Associates (LOR) that promised investors guaranteed risk management of their stock portfolios.⁴²

The functional strategy behind LOR's portfolio insurance was rather simple. Every time the S&P 500 moved up or down within the NYSE, the insurance would adjust by either selling or buying S&P 500 baskets. Again, the difficulty was not the strategy, but programming algorithms that used data to immediately track the fluctuations of the NYSE. However, quickly buying and selling within the NYSE remained difficult. Backlogs and human error could muddy the constant stream of orders that made portfolio insurance possible. LOR responded by advising their clients to use the "synthetic markets in Chicago"—Melamed's S&P 500 futures market—rather than only rely on the "real stock market."⁴³ Because the CME futures market bundled multiple stocks from the S&P 500, what would take hundreds of trades in the NYSE only took one trade in the CME. This reduced the cost, and increased the speed and volume of trades, thus allowing portfolio insurance to create a highly efficient and profitable strategy.⁴⁴

Portfolio insurers and index arbitrators are a match made in heaven. The main strategy for portfolio insurers was to buy when the market is rising above 3 percent, or sell when the market falls 3 percent. Congruently, "an index arbitrageur attempts to profit when the price difference is abnormal, either by simultaneously buying futures contracts and selling the index portfolio of stocks or by doing the reverse."⁴⁵ When the CME futures market is rising, "the

⁴² Hill, "Commentary on the October 1987 Market Crash - Portfolio Insurance – Another Easy Scapegoat," The Financial Futures Department Kidder, Peabody & Co., 1988, CBOT Part 2, Series 3, Box 15, Folder 11, pgs. 9-11; Henrique, *A First-Class Catastrophe*, 115-20, 150-52, 201-04.

⁴³ Metz, *Black Monday*, 75.

⁴⁴ Merton H. Miller, "Financial Innovations and Market Volatility," Mid America Institute for Public Policy Research, 1987, CBOT, Part 2, Series 3, Box 16, Folder 1, pgs. 11-13.

⁴⁵ Brady Commission Report, 7.

arbitrator . . . buy[s] the stock portfolio and sell[s] futures.”⁴⁶ The opposite is also true. If the market falls by 3 percent or more, portfolio insurers want to sell their contracts. The best price they will receive for these falling contracts are from index arbitrators who are who are buying futures contracts as they sell off their NYSE holdings.⁴⁷

According to the Brady Report, this created two significant outcomes. First, the connection between portfolio insurers and “Index arbitrage provides a direct linkage between the stock and index futures market.”⁴⁸ The constant buying and selling of futures on the CME and stocks on NYSE by arbitrators and portfolio insurers effectively connected what were previously thought as two separate markets in Chicago and New York into one market.⁴⁹ Secondly, and more importantly, portfolio insurers’ strategy was the “ability to use stock index futures to trade the entire ‘stock market,’ as if it were a single commodity.”⁵⁰ Just as wheat from multiple farms came together to create a single commodity—the wheat future—stocks of multiple corporations came together to create a single commodity, the S&P 500 future. Or, as the Brady Report described: “traders and investors treat the stock market as if it were a single commodity rather than a collection of individual stocks.” This, of course, was a fundamental idea explored in the previous chapter. The important point, then, is not simply the recognition that the NYSE was a commodity, but how this effectively reshaped the American economy into a commodity bubble.⁵¹

⁴⁶ Brady Commission Report, 6.

⁴⁷ Metz, *Black Monday*, 81.

⁴⁸ Brady Commission Report, 55.

⁴⁹ Interestingly, even the CME and NYSE continued to see themselves as separate markets throughout the period. In 1986, Leo Melamed headed a task force to formalize the trading link between the two exchanges. See “News Release: New York Stock Exchange and Chicago Mercantile Exchange Form Joint Task Force; will explore Establishment of Trading Link,” April, 1986, CME Series 2, Box 43, Folder 8.

⁵⁰ Brady Commission Report, 7.

⁵¹ Miller, “Financial Innovations and Market Volatility,” Mid America Institute for Public Policy Research, 1987, CBOT, Part 2, Series 3, Box 16, Folder 1, pgs. 11-13.

In review, index arbitrators make a profit by buying low in one market and selling high in another. In this case, an arb would buy falling NYSE stocks and sell rising S&P 500 futures indexes on the CME. This tactic perfectly aligns with portfolio insurers strategy, as they want to purchase futures as they rise in prices, and sell stocks as they fall, or vice versa. The constant transactions between these two groups effectively connected the NYSE and the CME into a single marketplace, while also reinforcing the fact that the S&P 500 futures market made the entirety of the NYSE into a single commodity. In an ideal, highly efficient world, this dynamic is not entirely terrible. As both groups buy and sell to each other, they are constantly updating the value of stocks, either in the future at the CME, or present at the NYSE. This constant “price discovery” is a key component of the futures market. However, this system is in danger of creating a feedback loop that can cause prices to spiral upward or downward. Especially if concentrated amounts of capital were to enter the market, thus causing outsized influence on the market with their transactions. This is exactly what happened in the years leading into 1987.

The concentrated capital of large institutions added amplitude to the feedback loop of the portfolio insurance - index arbitrage exchange. This dynamic explains both how the financial market grew so quickly in such a short time, and how the financialized economy is directly related to the previous industrial economy. Throughout the congressional hearings on Black Monday, representatives fixated on the role of, and harm to, small individual investors. In their minds, Wall Street offered a path for the average American to invest in the economy. While the ideal of an “investor democracy” rang true in the 1980s, the actual organization of investment on the ground was far from how congressional representatives conceptualized it.⁵² According to

⁵² Julia C. Ott, *When Wall Street Met Main Street: The Quest for an Investors' Democracy* (Harvard University Press, 2011).

Brady, the “individual investor wasn't a very big part of the activities of mid-October.” This was not because, as Senators implied, that the investor “could not get his phone answered,” and thus unable to trade during the days surrounding Black Monday. But rather because “the individual investor is a buy and hold guy . . . he takes a long view . . . individuals are the guys that stay there, through market turbulence” Instead, it was the large “institutions that do the trading.”⁵³

It was not masses of individual investors looking to make fast money, nor market manipulation and outright fraud that caused the collapse.⁵⁴ Rather, the strategy of large institutions, specifically mutual funds, lay at the center of growth and collapse. Leo Melamed recognized this shift:

[D]ecision making power in matters of finance has become compressed . . . investment managers now represent over 33 million mutual fund shareholders and over 60 million pension plan participants These funds equal nearly \$2 trillion in assets compared . . . to only \$400 billion a mere decade ago.⁵⁵

In short, there were large pools of capital in the hands of relatively few professional managers. This dynamic enabled “even small investors to equal the profit capabilities of institutional participants” because hedge funds effectively combined small investors into one large

⁵³ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Nicholas Brady Responding to Senator Christopher Bond, 52.

⁵⁴ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Nicholas Brady commenting on Market Manipulation, 62.

⁵⁵ Melamed, “Special Report: Embracing Reality,” in “1988: Market Dynamics Realign,” January, 1988, CME Series 1, Box 2, Folder 4, p.13.

institution.⁵⁶ This development was unsurprising for Melamed and the CME, as they had actively pursued investment from mutual funds and institutional investors for years.⁵⁷

It is important to understand that these institutions were not only composed of investments from incredibly rich individual Americans. They were “not a bunch of robber barons.”⁵⁸ Rather, their wealth was the savings of millions of Americans. Pension funds were the largest investor in mutual funds that used portfolio insurance. Mirroring the argument made by Giovanni Arrighi in *The Long Twentieth Century*, the previous form of capitalism effectively funded the rise of the new as the labor of millions of Americans who had worked through the high years of industrial capitalism funded the dramatic growth of financial capitalism in the mid-1980s.⁵⁹ As the Chairman of the Commodity Futures Trading Commission, Kalo Hineman elucidated, “these institutional investors are not faceless. They are our retirement funds, our university endowment funds, and so forth, and they are large mutual funds.”⁶⁰

This is no small detail. In fact, it illustrates that a central aspect of financial production is that it incorporates the savings, and thus economic wellbeing, of millions of Americans. As Senator Alan Dixon (D IL) explained, General Motors was “a \$40 billion pension fund” with “895,000 participants” the “vast, vast majority of those people [were] blue collar workers whose pension fund that they have invested in all through their considerable working lifetime is protected by the fund so that they will be able to enjoy the fruits of their labors during their

⁵⁶ Melamed, “Special Report: Embracing Reality,” in “1988: Market Dynamics Realign,” January, 1988, CME Series 1, Box 2, Folder 4, p.13.

⁵⁷ “News Release: Options Futures Key to Improving Portfolio Performance,” Chicago Mercantile Exchange, March 25, 1986, CME Series 2, Box 60, Folder 1; Melamed, “Using Financial Futures,” Speech Presented at the 1980 International Corporate Finance Conference in Zurich Switzerland May 13, 1980, CME Series 2, Box 66, Folder 4; Melamed, “Financial Futures for the Corporate Treasurer,” Speech Presented at the 1980 International Corporate Finance Conference in Zurich Switzerland, May, 1980, CME Series 2, Box 66, Folder 4.

⁵⁸ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Senator Alan Dixon, 67.

⁵⁹ Giovanni Arrighi, *The Long Twentieth Century: Money, Power and the Origins of our Times* (Verso, 1994, 2010).

⁶⁰ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Commodity Futures Trading Commission Acting Chairman Kalo Hineman, 230.

retirement years.” Their strategy is to have “whatever company they are investing in, a long long time from now will have appreciated in value like their own historical experience and their daddy’s experience was a long time ago.”⁶¹ Accordingly, “most of the investors that were participating in the market were small investors . . . through their participations in pension funds and mutual funds.”⁶²

However, the investment strategy used by mutual funds were not like the investors’ daddy’s experience. Senator Dixon explains a classic example of how pension funds worked. Retirement savings were mostly invested in the same company that employed the laborer. This was supposedly a way to democratize the workplace, as former laborers would become shareholders. However, by the 1980s, this was not the strategy. Pension funds were incorporated into mutual funds, and as such, became part of new investment strategies, including the portfolio insurance model. Thus, instead of investing in one corporation, retirement savings were used to invest in the S&P 500 on the NYSE and the futures market at the CME. As Senator Donald Reigle (D MI), explained, an “individual shareholder . . . are in there with these multimillion, sometimes tens of millions of dollars worth of trading blocks going through at a time” These mutual funds do not buy individual stocks, but rather the blocks of stocks sold as an S&P 500 share or futures contract. Just as a futures trader does not buy individual grain from a single farm, but mixed bushels from across the wheat belt. Thus, “stock equities are more and more being thought of as almost like commodities.” This investment strategy allows them to go “in or out of the stock markets or in or out of gold or in or out of foreign currencies or whatever . . . and they come in and out of the market that rapidly.” This phenomenon illustrates the shift away

⁶¹ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Senator Alan Dixon, 67. Nicholas Brady agreed to this description.

⁶² U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Senator David Karnes, 230.

from the long-term Return on Investment (ROI) model, into a short term, Return on Equity (ROE) model explored in chapters two and three.⁶³

The concentration of wealth and use of a commodity-based speculation mindset had an immediate effect as both the CME and NYSE rapidly grew. According to Brady, “the amount of index funds under portfolio insurance went from \$20 billion to \$60 billion in roughly one year,” from 1985 to 1986.⁶⁴ The rapid increase in investment funds led to more and more money in the hands of a few mutual funds.

This combination created a “herding effect.” Per the portfolio insurance playbook, as the NYSE market cooled and the CME futures market grew, wealth managers would sell their NYSE stock and use the profit to invest in CME futures. Much like a herd of elephants going from one watering hole to another, “a big institution hitting a keyboard and selling \$25 million stocks in thirty seconds” would signal to other institutions to follow.⁶⁵ Billions of dollars flowed into the CME, creating record highs in trading volume and profits between 1985 and 1987.⁶⁶ As more money flowed into the CME seeking to buy the S&P 500 futures index, the value of the futures index rose accordingly.

The mutual fund managers did not talk to each other to coordinate their buy and sell programs. They were simply following the portfolio insurance strategy. As Brady explained: “This trading activity was concentrated into the hands of a surprisingly few institutions. On October 19, sell programs by three portfolio insurers accounted for just under \$2 billion in the

⁶³ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Senator Donald Reigle, 66.

⁶⁴ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Nicholas Brady responding to Chairman Alan Dixon, 64. Accounting for inflation, this amount is equal to a growth of \$51 billion to \$153 billion in today’s dollars.

⁶⁵ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Nicholas Brady responding to Senator Paul Sarbanes, 63.

⁶⁶ “Chicago Mercantile Exchange Annual Report: 1990,” The Chicago Mercantile Exchange, January 1990, CME Series 1, Box 2, Folder 7; “Trading Volume in S&P Options Reaches All-Time Weekly High,” CME Series 2 Box 6 Folder 1.

stock market; in the futures market three portfolio insurers accounted for the equivalent on value of \$2.8 billion of stock. Block sales by a few mutual funds accounted for about \$900 million of stock sales.”⁶⁷ All it took was a few mutual funds, representing the savings of millions of Americans, to have a dramatic impact on the market.

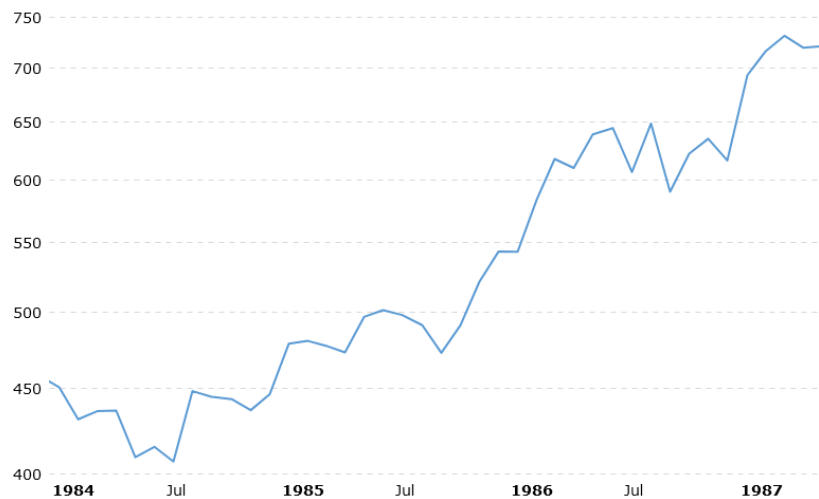


Figure 10. S&P 500 Stock Market Index, 1984-1987.⁶⁸

Congruently, arbitrageurs would notice the massive sell-off by mutual funds in the NYSE. They in turn would implement their strategy to buy these the S&P 500 index at a “discount,” believing that they would soon rise in value. The more arbitrageurs bought on the NYSE, the more the value would slowly rise. As the value hit that critical 3 percent growth point, mutual funds would sell their futures in the CME and use the profits to invest back into the NYSE. Then the arbitrageurs would by index futures contracts at discount, repeating the cycle. This feedback loop took hold after 1984, causing the S&P 500 value to nearly double by 1987.

As Brady stated “It simply grew.”⁶⁹

⁶⁷ Brady Commission Report, V, 41.

⁶⁸ “S&P 500 Index - 90 Year Historical Chart – 1980 to 2023,” Macrotrends.net, last accessed March 22, 2023, <https://www.macrotrends.net/2324/sp-500-historical-chart-data>

⁶⁹ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Nicholas Brady responding to Senator Paul Sarbanes, 63.

Portfolio insurance was just one of many new financial strategies of the era that helped create the Great Bull Market and the Reagan Recovery of the 1980s. However, it illustrates a fundamental point—financial markets began to operate exactly like a commodity bubble. If we remember back to chapter one, the first step in creating the commodity bubble that eventually resulted in the Farm Crisis was Nixon lowering interest rates on loans to farmers. This was done in order to finance the planting of grain “hedgerow to hedgerow.” The increased output thus drove up the value of the underlying land, which was then used as collateral for larger loans to plant more grain, reinforcing the cycle. As described above, the “commodity” is the entire NYSE, represented by the S&P 500 index here (the Dow Jones Industrial Average could also be used if we were to look at the Chicago Board of Trade). The concentrated wealth represented by mutual funds acted as Nixon’s cheap loans, pushing capital into the market. Like the Iowa land, the underlying stocks became more valuable as their price rose with the market. The key difference is that Iowa produced an increased amount of corn, a material good, for the world market. The rising value of stocks did not automatically mean the underlying corporations were more profitable, or using these funds for research and development, expanding labor, or produce anything tangible that would benefit the material world.

“It simply grew.” And grew. At this point, the novel ideas of portfolio insurance, financial futures, and the commoditization of the NYSE became something old. These new hedging instruments invariably created a new means of speculation. As the market rose, more and more institutions invested, seeking ever higher returns. As Alan Greenspan explained in his Congressional testimony, “prior to the drop, the market had run up to very high levels. The bull market from 1982 onward was nurtured by a favorable economic setting for businesses which

investors came increasingly to view as likely to be sustained. . . . In essence, there was an illusion of liquidity that likely encourage larger equity positions on the part of many investors.”⁷⁰

Financial traders began to think that what goes up surely can never go down.

The rising market and promise of certain returns on investment pulled more money into the system, driving up the price of the index funds, even though there was no real underlying reason for such rapid growth. Melamed agreed with this sentiment, stating that the “silly people who believed that the tulip-mania of the 1980s would never end” caused unearned growth.⁷¹ While Melamed blamed the traders’ irrational expectations that “the stock market would go up forever,” Brady blamed the system.⁷² Greenspan seemed to side with Brady, stating that if the recommendations of the Brady Commission had been in place, and portfolio insurance was heavily regulated and restricted, then “the market would have gone up less in the early months of 1987 and as a consequence would have been less out of line and, therefore, there would have been less of a downside reaction.”⁷³ But they were not in place. Instead, “Portfolio Insurance led investors to be overconfident, thinking that they could always hedge their portfolio stocks at a moment’s notice.”⁷⁴ Portfolio insurance had tamed the risk of investment, allowing funds to shift between the CME and NYSE almost immediately, constantly hedging against loss. An imagined future with no downturn ruled. The market rose. Until it did not.

“The market plunge was an accident waiting to happen.” In the middle of his Congressional testimony, Greenspan offered a short explanation of the banality of the effects of

⁷⁰ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Federal Reserve Chairman Alan Greenspan, 82, 85.

⁷¹ Melamed, “Who Killed Cock Robin?,” Speech Presented at the American Bar Association Committee on Futures Regulation, Acapulco, Mexico, January 23, 1988, CME Series 2, Box 66, Folder 6, p.1.

⁷² Melamed, “Who Killed Cock Robin?,” Speech Presented at the American Bar Association Committee on Futures Regulation, Acapulco, Mexico, January 23, 1988, CME Series 2, Box 66, Folder 6, p.1.

⁷³ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Alan Greenspan, 106.

⁷⁴ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Nicholas Brady, 64.

speculation. A few months prior to the crash, “real rates of return on equity investments indicated that such returns were at historically low levels” The gains made were not the result of any type of real economic output. The unrealistic growth of the financial markets was subject to a market correction to restore trading “to more normal levels” by a “pronounced drop in share prices.”⁷⁵

It was the direct connection between the more speculative commodities futures market in Chicago with the NYSE that created the fundamental dynamic of rising stock prices that resulted in the crash of 1987. According to Greenspan, hedge funds implementing the portfolio insurance strategy “came to believe that the futures market offered a separate haven of liquidity sufficient to allow them to liquidate huge positions over short periods of time with minimal price displacement.”⁷⁶ Because they thought the CME market was entirely separate from the NYSE, hedge fund managers assumed that they could always immediately sell millions of shares in a market to ready buyers in order invest in the other. However, ““In October, this belief proved to be unrealistic” as the futures market “simply could not absorb such selling pressure without dramatic price declines.”⁷⁷

As stated above, portfolio insurance encourages a herd mentality. Once one large hedge fund starts selling, others join as the growth of the market goes below the magic 3 percent threshold. In October, hedge funds began selling *en masse*. According to Brady, “This selling, in turn, stimulated further reactive selling by portfolio insurers and mutual funds” which led to “fears that a clearinghouse in one market segment might be unable to deliver funds owed to investors ignite[ed] concern throughout the entire system.”⁷⁸ This rippled through the entire

⁷⁵ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Alan Greenspan, 84.

⁷⁶ Brady Commission Report, 55-56.

⁷⁷ Brady Commission Report, 55-56.

⁷⁸ Brady Commission Report, 55.

financial marketplace creating a mass selloff. When the CME opened on October 19th, a trader saw “Nothing but sellers. All at the market. Market was immediately down. Human beings took their brains out of their heads and they just did what the computer told them to do. The computer told them to sell, so, oh my God, I have to sell.”⁷⁹ Again, there was no specific cause for the selloff. Once initiated, the portfolio insurance model created an irrational marketplace, one where the computer told traders they had to sell, despite the obvious outcome that everyone selling at once would create a crisis.

Selling pressure “washed across to the stock market.”⁸⁰ This does not take a fancy model to explain. If the future price of the commodity you are holding—the S&P 500 index—starts plummeting, then the current price should soon follow suit. The logical step would be to sell in order to ensure profit before the value bottoms out. Massive sell calls in both the CME and NYSE sparked a liquidity crisis. Arbitragers could not take advantage as both markets were in sell mode. Portfolio insurance further pushed traders to sell. “On October 19 and 20, institutions holding multibillion dollar portfolios simultaneously pursued similar strategies in a declining market, causing a rush for the exits that accelerated the decline”⁸¹ For Greenspan, “the initial rapidity of the price correction to an overvalued market . . . contributed to historic declines in prices.”⁸² No institution would risk buying massive number of shares needed to stabilize the market because they could lose millions in the course of minutes as the market continued to fall. As the S&P 500 futures value plunged in Chicago, New York responded accordingly by selling

⁷⁹ “Remembering Black Monday,” WYNC, <https://www.youtube.com/watch?v=xY8gW0snprg&t=1s>.

⁸⁰ Brady Commission Report, V, 55-56.

⁸¹ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Statement of David S. Ruder, Chairman of the Securities and Exchange Commission, 137.

⁸² U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Alan Greenspan 86.

shares of the S&P 500 index, deepening the crisis. The magic of the market—that there was always a buyer for what you were selling—evaporated.⁸³

The sell-off rippled across the world as financial markets in Tokyo, Singapore, and London attempted to unload their shares in the American marketplace. Everything was interconnected. In the words of Leo Melamed, “Europe, North America, and the Far East had become a continuous market reacting to news instantaneously and reaching across all time zones. Markets that had been separate rivers had suddenly combined to become oceans . . . And when everything kicked in at once, the markets became a monster frothing at the mouth and trampling anything in its way until the rampage ended.”⁸⁴ Within hours, the scale of the crash dramatically increased. “More than \$500 billion in paper value—a sum equal to the entire gross national product of France—had vanished in a sea of orders totaling 608 million shares.”⁸⁵ As Senator Reigle aptly noted, by October 20th, three days of losses resulted in a “market break [where] worldwide \$1.7 trillion worth of value evaporated. It was there one day. Bang, it was gone the next.”⁸⁶

⁸³ Hill, “Commentary on the October 1987 Market Crash,” The Financial Futures Department Kidder, Peabody & Co., 1988, CBOT Part 2, Series 3, Box 15, Folder 11; “October 1987 Stock Market Crash—CBOT ‘Performance’ Statement, 1988,” CBOT Part 2, Series 3, Box 15, Folder 9; William J. Brodsky, “The President’s Report: Level Heads, Open Markets,” in “1988: Market Dynamics Realign,” January, 1988, UIC Archives, CME Series 1, Box 2, Folder 4, p.6.

⁸⁴ Melamed, *Back to the Futures*, 357.

⁸⁵ Melamed, *Back to the Futures*, 357.

⁸⁶ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Senator Donald Riegle, 275. Chapter one of the Brady Commission Report further elucidates this point: “From the close of trading on Tuesday October 13, 1987 to the close of trading on October 19, 1987, the Dow Jones Industrial Average (‘Dow’) fell 769 points or 31 percent.” “In those four days of trading, the value of all outstanding U.S. stocks decreased by almost \$1.0 trillion.” “On October 19, 1987, alone, the Dow fell by 508 points or 22.6 percent.” “Since the early 1920’s, only the drop of 12.8 percent in the Dow on October 28, 1929 and fall of 11.7 percent the following day, which together constituted the Crash of 1929, have approached the October 19 decline and magnitude.” See, Brady Commission Report, 1-5.

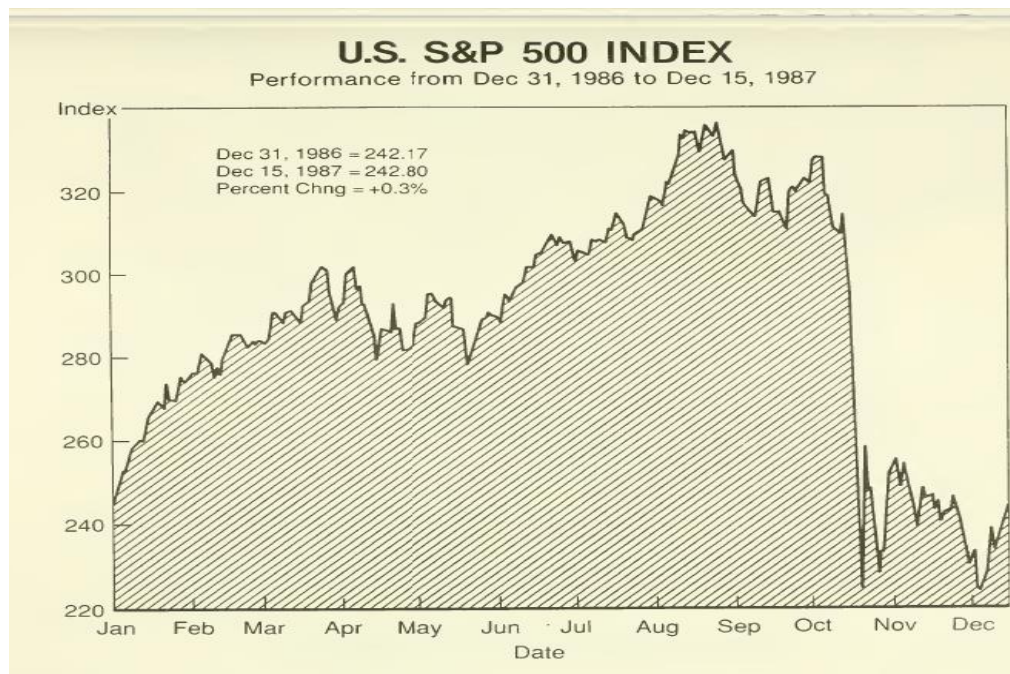


Figure 11. Brady Report, I-31 (Appendix 5-b)

Before moving on, let us take a moment to consider the deeper implications of the crash. Do the events of October 1987 prove that the Great Bull Market of the 1980s, and thus the Reagan Recovery, were all smoke and mirrors? Was the entire period one speculative bubble that collapsed in a matter of a few days? In some regards, yes. Although the S&P 500 index was just one of many financial instruments in play through the 1980s, they reflect in the purest form how imagination dominated the marketplace. As investment sloshed from the CME to the NYSE and back, the index rose in value, even as the real economic output of the corporations that the index represented did not necessarily post higher profits. This reflects Robert Reich's paper

entrepreneurialism that was explored in chapter two. Stock prices, tax cuts, and even mergers reflect gains on paper. However, real productive economic output does not necessarily follow. As stocks and corporate assets grow, they are not always reinvested back into production, resulting in increased wages. Furthermore, appreciating gains furthers the belief that growth will continue, resulting in more investments, and thus more growth on paper.

However, this period did also mark a period of material production. As explored in chapter three, financial investment schemes resulted the construction of buildings across America. Sure, some of these buildings may be empty and unneeded, but they employed millions of Americans. It is important to remember that the 1986 tax reform, Savings & Loan crisis, and 1987 Crash all occurred almost simultaneously. While the S&P 500 index offers the most concise view of a fully imagined financial asset—a commodity based upon the NYSE itself—it was not the only horse in the financialization race.

The point is that all these seemingly diverse crises were in fact connected through the financial markets. The 1981 tax cuts helped fuel the savings and loan industry's speculative turn after congressional deregulation. Corporate entities took advantage of lowered depreciation costs to build empty buildings and in turn used the tax savings to buy other businesses, or invest in themselves through newly legalized stock buy-back schemes.⁸⁷ This in turn increased the value of the corporation. And, if said corporation was part of the S&P 500 index, resulted in higher values on the NYSE and CME markets. The Tax Reform Act of 1986 ended the Accelerated Cost Recovery System, which eventually ended easy funding for S&L investments, helping to

⁸⁷ In 1982, the Securities and Exchange Commission changed a rule to allow companies to buy back their own stock, without being charged with stock manipulation. This in turn reduced the number of shares in the market, causing their price to go up. See Bagwell, Laurie Simon and John Shoven, "Cash Distributions to Shareholders," *Journal of Economic Perspectives*, Vol. 3 No. 3, (Summer, 1989), 129–140.

cause that crisis.⁸⁸ Financialization interconnects the American economy in ways that were not previously possible. Your savings might be used to fund the development of windmills in Arizona, or hedge against losses on the Chicago futures exchanges. Your mortgage may be bought and sold as a commodity across the world. Tax reform narrowly targeting an obscure corporate strategy can cause massive unemployment in the construction industry.

But the 1987 Crash did not bring an end to the Reagan Recovery. In fact, it was just a blip in a period of incredible financial growth. How did this happen? According to Melamed, “There [was] no mystery about it. The Federal Reserve’s release of liquidity to the market . . . turned the situation around.”⁸⁹ Paralleling the Savings & Loan Crisis, the Federal Reserve’s intervention into the market staved off severe calamity. Again, Melamed asserted that the “world never knew how close we came to a serious problem” because the Fed’s actions “saved the financial system.”⁹⁰

For Greenspan, the Fed’s actions were unremarkable. After all, “[The Federal Reserve’s] purpose was to limit any damage from the collapse in financial markets on the economy.”⁹¹ In order to do so, “The Federal Reserve adopted a strategy following October 19 aimed at shrinking irrational reactions in the financial system to an irreducible minimum. By demonstrating openly our determination to meet liquidity demands, we could, in practice, reduce those demands to the extent they arose from exaggerated fears.”⁹² Greenspan understood the role of the Fed as the lender of last resort. When no other institution would invest due to “exaggerated” or very real

⁸⁸ William K. Blackman, *The Best Way to Rob a Bank is to Own One: How Corporate Executives and Politicians Looted the S&L Industry* (University of Texas Press, 2005).

⁸⁹ Melamed, *Back to the Futures*, 370-71.

⁹⁰ Melamed, *Back to the Futures*, 360.

⁹¹ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Alan Greenspan 83.

⁹² U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Alan Greenspan 83.

fears of losing everything, it was the role of the Fed to “inject liquidity” into the financial system. Or to put it another way, when the magic of the market failed and there were no buyers, the Federal Reserve’s role was to fill that void to curb the massive sell-off and show that the market would not continue to fall. This “orchestrate[d] injections of liquidity into the American financial system” gave confidence to other institutions to buy, thus creating a countermovement to the massive selloff, effectively putting a floor under the collapse.⁹³

On the surface, this is a very simple and straightforward measure that successfully ended the market plunge. In the technocratic and passive words of the Brady Report, “Timely intervention by the Federal Reserve System provided confidence and liquidity to the markets and financial system.” The Fed fulfilled its mandate and stabilized the market. However, in perhaps a surprising move considering Nicholas Brady’s history as a staunch pro-business Republican, the Brady Report did not shy away from raising the threat of moral hazard. According to the official government investigation, a central problem with the “Federal Reserve as the intermarket agency is the danger that market participants may take on more risk in the expectation that the Federal Reserve will bail them out in a crisis.”⁹⁴ The fear was that traders, knowing that the government will bail them out, accept a higher level of risk in their day-to-day business. Combined with the “rational that portfolio insurance would cushion the impact of a market break by allowing them to shift quickly out of stocks” traders believed that investments could be easily and instantaneously transferred to and from the NYSE to the CME, with the federal government as a backstop to all risk.⁹⁵ In other words, these highly speculative moves were not recognized as such because portfolio insurance created an aura of mathematical stability, and the Federal Reserve would effectively bail out the investors if the system collapsed. As with the actions

⁹³ Melamed, *Back to the Futures*, 355.

⁹⁴ Brady Commission Report, 62.

⁹⁵ Brady Commission Report, 62.

taken by Congress to bail out the S&L industry seen in Chapter 3, the Fed's injection of liquidity acted as a form of insurance for the financial system.

Alan Greenspan rebuked this position. During his congressional testimony, he stated that “We are concerned that there is a general view that if one gets into an unduly risky position, that the Federal Reserve is there to bail out the situation. We are not. What we are there for is to protect the total system in the event that we run into a financial crisis. That is [why] we took the particular actions we took on October 19.”⁹⁶ Greenspan is correct in that the Fed did not pick winners and losers by targeting specific hedge funds to infuse with capital. But, at what point does this defense become a case of hairsplitting? Individual firms will not be bailed out; instead “the total system,” which includes those individual firms, was saved. Yet, the system collapsed due to the actions of a few hedge funds that had access to billions.⁹⁷ Concentrated capital effectively made “the total system” a handful of investment firms. This dynamic would eventually become the centerpiece of the “Too Big to Fail” doctrine that led to the federal bailout of investment banks following the 2008 crash.⁹⁸

Nevertheless, Greenspan's testimony provided assurance to the Congressional Banking Committee. The specter of moral hazard quickly faded from the hearing, replaced with an illuminating discussion about the balance between self-regulation and the role of government intervention. Senator Proxmire asked Leo Melamed a simple question: “In a crisis, can we realistically expect the regulators and the self-regulating organizations to cooperate?”⁹⁹ Recalling the position of the CFTC and SEC in the previous chapter, self-regulation was “the heart of the

⁹⁶ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Alan Greenspan response to Senator Christopher Bond, 111.

⁹⁷ Brady Commission Report, 15.

⁹⁸ Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* (Illinois: BN Publishing, 2011).

⁹⁹ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Senator William Proxmire to Leo Melamed, 269.

regulatory scheme embodied in the Commodity Exchange Act.”¹⁰⁰ Self-regulation was touted in the *Congressional Record* because marketplace was far too complex for any one agency to competently regulate. “The [CFTC] does not have the resources and cannot be expected to have the capability of surveilling every nook and cranny of the futures market.”¹⁰¹ Melamed concurred with this understanding, assuring the Committee that the private sector successfully coordinated with the CFTC and SEC.¹⁰²

Brady’s analysis directly countered Melamed. After investigation, he concluded that that it was “apparent that many of the major participants themselves did not fully understand the nature of the markets.”¹⁰³ According to Brady, hedge funds that implemented portfolio insurance did not understand that they had effectively created one market between Chicago and New York. So, then, if those who partook in the market directly did not understand the dynamics of the market, how could self-regulation prevent collapse? Was the entire premise of the marketplace—deregulation and free market supremacy—wrong?

Not so, according to Melamed. In an internal CME report, Melamed stressed that portfolio insurance and program trading were strategies, not products. Financial products could be defined by Congress, as explored in the last chapter. Strategies, however, should not—they were a type of speech, limiting strategies was akin to limiting creativity and free speech.¹⁰⁴

Responding to questions of renewed market regulation, Melamed contended that “portfolio

¹⁰⁰ Representative George Hopkins, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24906.

¹⁰¹ Representative George Hopkins, speaking on “Providing for Consideration of H.R. 5447, Futures Trading Act of 1982,” 97th Cong., 1st sess. *Congressional Record* Vol. 128 (Sept. 23, 1982), 24906.

¹⁰² U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Leo Melamed responding to Chairman Proxmire, 270.

¹⁰³ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Nicholas Brady, 36.

¹⁰⁴ “Memorandum: To The Membership. From: Board of Governors. October 26, 1987. RE: Recent Events Relating the S&P 500 Futures and Options,” CME Series 2, Box 53, Folder 4, pgs. 2-4; Melamed, “Special Report: Embracing Reality,” in “1988: Market Dynamics Realign,” January, 1988, UIC Archives, CME Series 1, Box 2, Folder 4, pgs. 12-13.

insurance and program trading are market strategies. I think that strategies should not be legislated for or against.”¹⁰⁵ Prohibiting, or even guiding, traders use of strategies would hamper their ability to create wealth. Remember that Melamed remade the CME through his novel introduction of financial futures that created wealth not only for the exchange, but the city of Chicago, and the nation. Regulating what strategies could or could not be used would effectively end the entrepreneurial spirit of the financial sector.

Furthermore, self-regulation did not necessarily fail for Melamed. Portfolio insurance was one of many “decisions that the market users make a determination about and to the extent they did not work . . . those strategies won’t be used again. I think the market place . . . will take care of its own.” Black Monday signified that portfolio insurance was a disastrous strategy, and it would not be used again. Further regulation simply was not needed.¹⁰⁶

Leo Melamed called the entire Congressional response—and much of Brady’s analysis—as being akin to “Salem 1692.”¹⁰⁷ Portfolio insurance did not emerge from the Chicago futures markets. Rather, it was a strategy used by hedge funds and other institutional investors that invested in New York and Chicago marketplaces. Why was Chicago the sole focus of new regulations? Melamed had an answer. “It was . . . unthinkable that so many successful financial advisers . . . could possibly have been so wrong” and “Never mind that all speculative bubbles must finally burst.” No, instead there must be “some villainous sabotage that stopped the six-year

¹⁰⁵ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Leo Melamed responding to Senator Alfonse D’Amato, 271.

¹⁰⁶ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Leo Melamed responding to Senator Alfonse D’Amato, 271.

¹⁰⁷ Melamed, “‘The Good Old Days’ The October 1987 Stock Market Crash: A Futures Market Perspective,” Speech Presented to Securities Regulation Institute, January 26, 1989, San Diego California, CME Series 2, Box 67, Folder 1, p. 3.

long bull market dead in its tracks.”¹⁰⁸ Soon enough, the “real villain” was found to be “those Chicago pits. They are evil, they are dens of speculation, purposeless and immoral.”¹⁰⁹ The same moral outrage that haunted the Chicago futures market since the nineteenth century had “focused . . . concerns in the wrong direction,” away from the obvious answer that speculation had simply grown out of hand, akin to another tulip craze.¹¹⁰

Melamed countered that Chicago’s futures markets were, in fact, the paramount of virtue. Instead of causing the crash “on October 19, 1987 . . . the futures index markets were the first to tell the truth. The truth was indeed too bad and too loud.”¹¹¹ The Chicago futures exchanges did not cause the panic, but were the first to announce that something was fundamentally wrong with the market. As we learned in the previous chapter, “price discovery” was one of the central roles of the futures market.¹¹² It was not the Chicago markets’ fault that investors suddenly devalued stock index funds; they simply let the world know that the opinion of the future worth of these funds had taken a turn. In the need to find a villain, according to Melamed, Congress, the media, and the Brady commission blamed the messenger.

The Chicago Board of Trade’s investigation of Black Monday concurred with Melamed. According to the official report, “Those few who have suggested that ‘program trading,’ ‘portfolio insurance’ and/or other aspects of options and futures stock index contract trading are

¹⁰⁸ Melamed, “‘The Good Old Days’ The October 1987 Stock Market Crash: A Futures Market Perspective,” Speech Presented to Securities Regulation Institute, January 26, 1989, San Diego California, CME Series 2, Box 67, Folder 1, pgs. 2-3.

¹⁰⁹ Melamed, “Who Killed Cock Robin?,” Speech Presented at the American Bar Association Committee on Futures Regulation, Acapulco, Mexico, January 23, 1988, CME Series 2, Box 66, Folder 6, p.2.

¹¹⁰ Melamed, “Special Report: Embracing Reality,” *in* “1988: Market Dynamics Realign,” January, 1988, CME Series 1, Box 2, Folder 4, p.12.

¹¹¹ Melamed, “‘The Good Old Days’ The October 1987 Stock Market Crash: A Futures Market Perspective,” Speech Presented to Securities Regulation Institute, January 26, 1989, San Diego California, CME Series 2, Box 67, Folder 1, p.6.

¹¹² William L. Silber, “The Economic Role of Financial Futures,” (American Enterprise Institute for Public Policy Research, 1985), 89.

the cause of the decline are misinformed.”¹¹³ In fact, the futures markets had acted valiantly by continuing with its mission to provide liquidity and a means for hedging throughout the tumultuous hours of October 19th and beyond. Again, according to the CBOT study, “Futures markets, far from being a cause of the market decline, performed their hedging and risk-transfer function admirably.” Because CBOT and CME remained open throughout Black Monday, the Chicago markets “provided a method ... to get out of the market by transferring their risk. We [CBOT and CME] thereby performed our market functions as established by the U.S. Congress.”¹¹⁴ Congruently, an internal CME memo stated that “The Chicago Mercantile Exchange S&P 500 futures and options contracts served as a pressure valve Monday, October 19” helping to reduce the volatility that had taken hold on the financial marketplace.¹¹⁵

The market, then, performed as intended. However, this did not prevent the speculative craze of the 1980s. Melamed, however, did not completely ignore this fact. In 1986, he began to sense that the gains of the NYSE and CME were becoming untethered from reality and “feared a stock market crash.”¹¹⁶ In such an event, the CME’s “S&P [futures] contract would be the first to signal bad news to the world. And I knew what people did to messengers with bad news.”¹¹⁷ In response, Melamed followed the logic of self-regulation and attempted to curb market growth using price controls: “If our S&P contract had prescribed daily price limit that it could not transgress, then our market could only fall so far on a given day. If a stock market meltdown occurred, futures market prices would remain well above the cash market levels.”¹¹⁸ Limiting the

¹¹³ “October 1987 Stock Market Crash,” “Performance Statement” and “Executive Summary” January 1988, CBOT Part 2, Series 3, Box 15, Folder 9.

¹¹⁴ “October 1987 Stock Market Crash,” “Performance Statement” and “Executive Summary” January 1988, CBOT Part 2, Series 3, Box 15, Folder 9.

¹¹⁵ “Internal Memo To The Membership From Board of Governors Date October 26, 1987 RE: Recent Events to the S&P Futures and Options,” CME Series 2, Box 53, Folder 4.

¹¹⁶ Melamed, *Back to the Futures*, 340.

¹¹⁷ Melamed, *Back to the Futures*, 340.

¹¹⁸ Melamed, *Back to the Futures*, 340-41.

amount the S&P futures contract could reach in any given day would effectively control how much the market could climb and push back against the growing speculative nature of the exchanges. Any dramatic drop-off on the NYSE would not transfer to the CME because limiting growth would allow for more liquidity to remain in the futures market.

Price controls are anathema to free market principles. Melamed knew this. He “felt strongly about the beauty of a market economy and were of a common mind against artificial restraints to market movements. . . . to suddenly suggest an arbitrary barrier to the free flow of prices was completely contrary to everything [Melamed] stood for”¹¹⁹ In an illuminating passage, Melamed clearly illustrates the difference between theory and practice. When finalizing his price control proposal, Melamed reached out to his hero, Milton Friedman. Melamed knew that “Friedman would react against any form of infringement on market movement. But then Friedman wasn’t running a futures exchange and wouldn’t have to contend with the political aftermath that I envisioned, if what I anticipated happening, happened.”¹²⁰ Melamed never knew if he “fully convinced Friedman” about the necessity of price controls, but he “did get him to understand that for me there were considerations that transcended pure economic ideology.”¹²¹ During a period of unparalleled growth for his exchange, Melamed feared that the same free market principles that motivated his entry into financial futures also could lead to their downfall. Ideas are needed when beginning a new venture, but at some point, those pure ideas meet real world dynamics and need to be adjusted to avoid calamity.

Unfortunately, “the entire exercise was to no avail.”¹²² Melamed was “nearly stoned to death” when he suggested a “12-point daily S&P limit” to “equity industry representatives.”

¹¹⁹ Melamed, *Back to the Futures*, 340.

¹²⁰ Melamed, *Back to the Futures*, 342.

¹²¹ Melamed, *Back to the Futures*, 342.

¹²² Melamed, *Back to the Futures*, 342.

There would be no price limits, and the market would continue to grow without restraints until October of 1987. Melamed would recall that “in the months that followed the 1987 stock market crash, I often reflected about how close I came to saving our markets from the criticism that ensued—a barrage that at times looked like the end of the futures markets.”¹²³

Despite the repudiation of price controls in the years prior to 1987, Melamed’s idea came to fruition during the market collapse. Four days after Black Monday, the CME “Board determined that the extreme volatility and unsettled market conditions required the temporary imposition of price limits to restore investor confidence.” In the moment of economic freefall, CME’s Board of Governors came to agree with Melamed that price controls “allow[ed] brokers and traders to operate more effectively during this period of unprecedented, rapid price fluctuations,” by putting a hard limit on the gains and losses that the Exchange could incur on a single day. Again, it is important to note that when the rubber met the road, Friedman’s free market visions were quickly modified to create stability and confidence within the market.¹²⁴

The Brady Report agreed with Melamed that price controls would have contained the market to a more stable growth trajectory. So-called “circuit breakers” are “mechanisms [that] involve trading halts Examples include price limits, position limits”¹²⁵ Like Melamed, the report contended that circuit breakers “counter the illusion of liquidity by formalizing the economic fact of life . . . that markets have a limited capacity to absorb massive one-sided volume.”¹²⁶ Caping the amount that the S&P 500 Index futures could grow in a single day would limit the imagination as to what is possible to sell and buy in a single day, thus preventing

¹²³ Melamed, *Back to the Futures*, 343.

¹²⁴ “Press Release: CME Takes Emergency Actions; Reduces S&P Hours; Imposes Price Limits,” October 22, 1987, CME Series 2, Box 53, Folder 4.

¹²⁵ Brady Commission Report, 66.

¹²⁶ Brady Commission Report, 66.

investors from “believing that it is possible to sell huge amounts in short time periods,” the primary assumption that led to the massive sell-off of Black Monday.¹²⁷

Both Melamed and the Brady Commission recognized the centrality of imagination in financial markets. As discussed in the previous chapter, trading in financial futures was yet further market abstraction from material commodities, such as wheat. Market growth was even less connected to real world output, creating a dynamic seen in 1987 where gains in the NYSE and CME dramatically outpaced any material economic growth. Thus, hemming in the unlimited imaginations of traders and investors through price controls and other circuit breakers was key to keeping the markets balanced on the highwire act between stable gains and speculative bubbles.

Brady, however, thought circuit breakers were only the bare minimum. Something more substantive had to be done to prevent another collapse. The most ambitious proposal of the Brady Commission’s report centered on expanding the role of the Federal Reserve. The complex interactions between Chicago and New York that led to Black Monday proved that “expertise in individual market segments” was “not sufficient for effective response to intermarket crises.”¹²⁸ The CFTC and SEC were both too narrowly focused on their respective areas of expertise to understand how the interactions between the two markets created instability. Thus, the Brady Commission recommended the creation of an “intermarket agency” that had “broad expertise in the financial system as a whole” to guard against the “potential risk of intermarket failure.”¹²⁹ This agency “needs independence to resist demands of partisan political and economic interests.”¹³⁰

¹²⁷ Brady Commission Report, 66.

¹²⁸ Brady Commission Report, 60.

¹²⁹ Brady Commission Report, 60.

¹³⁰ Brady Commission Report, 60.

According to the Brady Commission, the Federal Reserve was “well qualified to fill the role of the intermarket agency.” The Fed already had a “primary responsibility for the health of the U.S. financial system.”¹³¹ The crisis of October 1987 “required the Federal Reserve to step in to inject liquidity to boost confidence”—therefore “intermarket failure and damage to the financial system [already fell] upon the Federal reserve” Because of this dynamic, “it could be argued that the Federal Reserve should possess the authority to prevent such an intermarket crisis.”¹³² If it was the Fed’s role to save the financial system, why should it not be its role to prevent catastrophe in the first place? The Fed was already “experienced in assessing interactions and imbalances among marketplaces, as opposed to intramarket concerns” of the CFTC and SEC. “It has experience in international financial market coordination . . . formal responsibility for margin requirements on stocks and stock options, [thus] [a]dding futures margins to the Federal Reserve’s purview would be a logical extension of its current responsibilities and not a major change.” And, most importantly, the Fed “has the ability, standing and influence to establish and coordinate consistent intermarket requirements and to inspire intermarket confidence.”¹³³

The main drawback to the Brady Commission’s proposal was the ever-present worry of moral hazard. Per the Brady Report, the “problem with the Federal Reserve as the intermarket agency is the danger that market participants may take on more risk in the expectation that the Federal Reserve will bail them out in a crisis.”¹³⁴ However, the Fed remained the best institution to take on new regulatory actions. Even if the air remained thick with moral hazard, there was “no requirement to guarantee the actions of any particular firm,” meaning that the Fed could let

¹³¹ Brady Commission Report, 62.

¹³² Brady Commission Report, 62.

¹³³ Brady Commission Report, 62.

¹³⁴ Brady Commission Report, 63.

specific institutions fail and still fulfill their role as investor of last resort. The risk of individual failure would keep institutions in line.

It is important to take a moment to fully understand the framing of the Brady Commission Report. The Chairman, Nicholas Brady, was a Reagan Republican. He was the chairman of multiple investment firms and worked in the banking industry for thirty-four years, and soon after submitting his report on the Crash of 1987, was named the Secretary of the Treasury by President Reagan. He was “a firm believer in keeping our markets as free from regulation and government intrusion as possible.” However, the events of Black Monday demonstrated the limits to the free market: “the events of October underscore that certain changes must be made to avoid future strain on our financial system. Without proper safe guards, a drop of the severity and speed of October can happen again, with even more far-reaching consequences.” For Brady, self-regulation had failed. It was instead time to “act to prevent a recurrence of the events of October. We are looking down the barrel, and the gun is loaded.” Expanding the regulatory role of the Fed and incorporating circuit breakers were “minor changes in existing laws which would harmonize crucial intermarket elements” that were “the key to avoiding a repeat of the October crises.” Regulation was perhaps the dirtiest word for a Reaganite, but according to Brady, “The cost is small, the benefit great.”¹³⁵

Soon after Black Monday, an unexpected ally joined Brady’s calls for stricter regulations: NYSE traders. In an especially enlightening, and rather amusing, *Time* article, Wall Street traders placed blame for the crash squarely on the shoulders of the Chicago futures traders. “I have nothing nice to say about Chicago. They've ruined everything,” lamented one. Their ire centered on the perception that Chicago futures had turned the NYSE into a highly speculative gambling den: “futures enable investors to place bets on the performance of New York stock

¹³⁵ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Nicholas Brady, 39.

indexes like the Standard & Poor's 500.” These futures trades, “gave investors the opportunity to . . . reap quick profits from temporary, often minor discrepancies between the two markets by launching simultaneous, computer-driven program trades of huge blocks of stock in New York and index futures in Chicago.”¹³⁶

According to these New York traders, the principles of stable, long-term growth that had, supposedly, guided the NYSE since 1929, were upended by the influence of Chicago speculators. “‘What stocks once represented,’ says Prudential-Bache's Ball, referring to long-term investment, ‘is being sublimated for something more frenzied.’” In total, “many New York traders view their Chicago counterparts as hotheaded and distinctly disreputable gamblers rather than investors.” As explored in chapter four, index futures both measured the entire value of the NYSE and effectively turned the market into a tradable commodity. The NYSE traders argued that the values of stock indexes created in Chicago essentially ran backward in time and affected the current, real-time value of the underlying stocks, creating a situation where “the tail is now wagging the dog” as “the stormy moods in Chicago's futures markets can directly influence the performance of underlying stocks and bonds in New York.” Wall Street traders had lost control over their own market. This dynamic directly parallels how wheat growers felt about Chicago futures traders at the end of the nineteenth century. Just like Midwestern farmers, NYSE traders saw themselves creating material goods, and wealth, for the nation. Their trading accurately represented the real value of corporate stocks, not only the perceived future value based on one’s

¹³⁶ Stephen Koeppe, “The War of Two Cities: New York and Chicago Fight a Turf Battle That is Depressing Markets and Stalling Reform,” *Time*, May 30, 1988, available at <http://content.time.com/time/subscriber/article/0,33009,967520-1,00.html>.

imagination. However, their livelihoods were directly impacted by the futures traders in Chicago who did not directly deal in the commodity they actively traded.¹³⁷

Virtue, for Chicago traders, was not formed by one's relationship to speculation. Instead, Chicago's culture placed equality and innovation as central to the creation of virtuous production. Tom Cunningham, "a 20-year veteran at the Board of Trade" emphasized that "No one gives a damn whether you're a college graduate. The guy on your right has a master's degree in chemistry, the one on your left is a high-school dropout. When the bell rings, you're all equals." Conversely, "even at its most hectic, the floor of the Big Board [NYSE] seems by contrast an elite gentleman's club." John Sandner, the Chairman of the Chicago Mercantile Exchange argued that jealousy, not morals, prompted the harsh words from New York: "We were so successful that it caused everyone to want to take our success from us. The agenda of New York is to move our markets to Wall Street."¹³⁸ Following this mindset, cries for regulations was just an attempt by the elite financiers of the NYSE to both steal the markets, and quell the equality and innovation, of the Chicago exchanges.¹³⁹

Congressional proceedings did not ease the "war" between New York and Chicago financial specialists. Although the Brady Report "recommended drastic reform that would have curbed Chicago's latitude," a second report submitted by a White House working group headed by Treasury Secretary James Baker and Federal Reserve Chairman Alan Greenspan "delivered a quite different report, one that essentially exonerated the futures markets."¹⁴⁰ Although this

¹³⁷ Koepp, "The War of Two Cities"; Jonathan Levy, *Freaks of Fortune: The Emerging World of Capitalism and Risk in America* (Harvard University Press, 2012), Chapter 7, "Trading the Future," 231-63.

¹³⁸ Koepp, "The War of Two Cities." This sentiment was echoed by Leo Melamed. See Melamed, "Who Killed Cock Robin?," Speech Presented at the American Bar Association Committee on Futures Regulation, Acapulco, Mexico, January 23, 1988, CME Series 2, Box 66, Folder 6, p.1.

¹³⁹ Koepp, "The War of Two Cities."

¹⁴⁰ Koepp, "The War of Two Cities."

statement is somewhat hyperbolic, the report directly countered Brady's by arguing that major regulatory reforms were not needed. When testifying before Congress, Greenspan essentially sided with Melamed by stating that only the "Brady task force recommendation for circuit breakers has some appeal."¹⁴¹ His report supported the implementation of circuit breakers that would stop trading in almost every U.S. financial market for one hour if the Dow fell 250 points from the previous day, and for two hours if it dropped by 400 points.¹⁴² Although this was a step in corralling the frenzied free fall of Black Monday—and a direct refutation of Milton Friedman's stated principles—the measure was modest compared to what Brady had posited.

Despite his support for circuit breakers, Greenspan continued to promote that market players themselves are far better at handling a crisis rather than the federal government. When testifying before Congress, Greenspan reiterated that "We must recognize that some of the factors contributing to the October break cannot realistically be corrected by public policy" and that "we do not want to lose sight of the important role that professional institutional investors play in managing our retirement programs and the assets of nonprofit institutions."¹⁴³ These professionals successfully managed the money of millions of Americans, ensuring their financial stability. Government regulation would, according to Greenspan, hamper these financial professionals' ability to secure further economic growth. Furthermore, for Greenspan the events of October 1987 should be seen as a success:

we must nonetheless not lose sight of the fact that we came through the crisis remarkably well, given what happened. No major brokerage firms failed. Unprecedented margin calls by the futures clearing houses were

¹⁴¹ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Alan Greenspan, 86.

¹⁴² U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Alan Greenspan responding to Senator Alan Dixon, 108-09; Koepp, "The War of Two Cities."

¹⁴³ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Alan Greenspan, 86.

met by their members and stock prices reached a new less vulnerable trading range shortly after the plunge.¹⁴⁴

Financiers may have caused the panic, but they also helped solve it. While it is impossible to fully get into the mind of Alan Greenspan, his testimony does get to the fact that a certain amount of double-think is needed in order to continue to support free market strategy after a near economic collapse.

In 1987 there was a sharp divide on what exactly threatened the health of the U.S. economy. For Brady, the risk of another financial collapse was akin to facing down the barrel of a loaded gun; conversely, for Greenspan and Melamed, the threat of regulation, and the corresponding economic slowdown, was the real threat to the American economy. “We have the most extraordinary financial system in the world, and it is a major factor in contributing to the standard of living we enjoy here” Greenspan stipulated. Therefore, Greenspan’s “concern is that if we unduly regulate our system in a manner which induces the business to go abroad, I think we will find that we will do some damage to our economy overall. That spreads out far beyond the stock market” because “these are not only New York jobs and Chicago jobs at stake. There are Rhode Island jobs, and those of other states—in short American jobs.”¹⁴⁵ Overall, “it is a very crucial advantage to this country to have a sophisticated liquid financial system that we have built up over the generations.”¹⁴⁶ Republican Senator Phil Gramm responded with, “Mr. Chairman, that reminds me of the goose that laid the golden egg.”¹⁴⁷

¹⁴⁴ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Alan Greenspan, 86.

¹⁴⁵ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Alan Greenspan, 87.

¹⁴⁶ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Alan Greenspan responding to Senator Bob Graham, 107.

¹⁴⁷ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Alan Greenspan responding to Senator Bob Graham questions, 107.

The metaphor of the goose that laid the golden egg appeared throughout the congressional hearing. In his opening remarks, Chairman Proxmire summarized that opposition to new regulations was based in the idea that they would “kill the goose that is laying the golden egg, and what we [Congress] should do is by feeding the goose and stroking the goose and helping the goose to recover.”¹⁴⁸ The Great Bull Market of the 1980s had fueled the Reagan Recovery. After a decade of stagnation, followed by a double-dip recession, the American economy was growing. Congress’s role was to protect that recovery, not end it.

As always, Leo Melamed provided an illuminating description of this golden egg economic model. The creation of the goose that lays golden eggs was not accidental. Just the opposite. “Stock index futures represented something new, a start departure from the past, and almost everyone had a secret longing for the simpler days of times gone by.”¹⁴⁹ When nostalgia for the American economy of the past reigned, it was the financiers in “The Chicago Mercantile Exchange, the Chicago Board of Trade and other futures markets in this country understood that now was the time to create a market to respond to changes in the world technology.”¹⁵⁰ Now, according to Melamed, “Brady’s recommendations were akin to a call for a return to those ‘good old days’ before there were stock market futures, before there was program trading, before index arbitrage.”¹⁵¹ However, in those good old days, “daily volume on the NYSE was a mere 11.5 million shares”¹⁵² Now, “there's somewhere between \$3 and \$4 billion in money that comes to the United States on a nightly basis, a third of which comes from foreign shores, and has a very positive effect on our balance of payment as a result of futures markets.”¹⁵³ New financial

¹⁴⁸ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Senator William Proxmire, 43.

¹⁴⁹ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Leo Melamed, 343.

¹⁵⁰ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Leo Melamed, 256.

¹⁵¹ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Leo Melamed, 344.

¹⁵² U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Leo Melamed, 344.

¹⁵³ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Leo Melamed, 282

products—specifically futures for Melamed—created a new engine for American economic growth. It was the duty of Congress to protect these new markets, not destroy them.¹⁵⁴

There was nothing that specifically kept the golden goose the singular domain of the U.S. economy. According to Melamed, “every capital center, every financial center in the world is envious and wants the formula of the creation of futures markets, to wrest from us the business that we bring to it . . . London and Paris have created futures markets and are attempting to wrest markets.”¹⁵⁵ Thus, as Senator Richard Shelby (D AL) explained, “If you weren't doing it here, if you couldn't do the things like index arbitrage and other things, portfolio insurance, in America, it's obvious that it would go somewhere else. . . . It could be in Germany. It could be in Hong Kong, anywhere they have a free market.”¹⁵⁶ The question then was “How can you really control or supervise a global financial market if we're just one of the players in it in the United States?”¹⁵⁷ For Melamed, the answer was simple: “I don't think you can control it. What you have to do is make our market accommodate that business, invite that business and make it strong enough that the business stays right here and not impede it from coming here.”¹⁵⁸ Brady's recommendations of expanded regulations would effectively push investment out of the United States, allowing some other nation to own the Golden Goose.

¹⁵⁴ Melamed's testimony was a recounting of a speech he gave to numerous audiences throughout 1988 and 1989. *See for example*, Melamed, “‘The Good Old Days’ The October 1987 Stock Market Crash: A Futures Market Perspective,” Speech Presented to Securities Regulation Institute, January 26, 1989, San Diego California, CME Series 2, Box 67, Folder 1.

¹⁵⁵ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Leo Melamed, 282.

¹⁵⁶ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Senator Richard Shelby questions Leo Melamed, 282. Richard Shelby was a Democrat at the time of this hearing. However, he switched to the Republican Party in 1994, reflecting the evolution of southern Democrats to Republicans throughout the decade.

¹⁵⁷ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Senator Richard Shelby questions Leo Melamed, 282.

¹⁵⁸ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Leo Melamed, 282.

All Congress had to do to maintain the production of never-ending golden eggs was to support people like Melamed, the new virtuous producers of American society. These financiers, according to Melamed:

think that our markets are an important element in the world today bringing to this country business that otherwise would go somewhere else. We are jealous of that business, sir. We want to guard it. We want to protect it for these United States, and we don't want to lose it to foreign competitors.¹⁵⁹

Luckily for Congress, Melamed explained that “I think we are very competent in maintaining these markets here.”¹⁶⁰ Furthermore, Melamed was “proud to tell you that these markets, when left to their own devices, in terms of using their imagination, innovation and American know-how, will protect their market share.”¹⁶¹ The only thing these virtuous producers “fear is an intervention by some forces that would regulate us out of ability to protect ourselves and then lose that market share.”¹⁶²

In the end, the allure of the Golden Goose was too much for Congress. After some deliberation, circuit breakers were the only regulatory reform enacted.¹⁶³ Melamed’s argument won the day—the role of Congress was to support, not limit, the virtuous producers of the new American economy. Under Greenspan, the Federal Reserve remained the lender of last resort,

¹⁵⁹ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Leo Melamed, 256.

¹⁶⁰ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Leo Melamed, 293.

¹⁶¹ U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Leo Melamed, 293.

¹⁶² U.S. Congress, Senate, Committee, *The Turbulence in the Financial Markets Last October*, Leo Melamed, 293.

¹⁶³ Circuit breakers have had success in quelling panic. The latest example was on March 9, 2020 when the Dow Jones fell by almost 8% because of fears of Covid and falling oil prices. Trading on Dow Jones and S&P 500 indexes funds and futures were halted for fifteen minutes to calm the nerves of traders. The process was repeated on the 12th, 16th, and 18th of March 2020. “Wall Street Plunges in Worst Drop Since 2008,” *New York Times*, March 9, 2020, <https://www.nytimes.com/2020/03/09/business/stock-market-today.html>.

leaving regulation to the CFTC and SEC. Portfolio insurance was abandoned in a move touted as effective self-regulation by the finance industry. New investment opportunities soon emerged, from internet startups to mortgage-backed securities, each creating their own boom and bust cycle. Throughout, the financial markets grew to the point where the calamity of 1987 was nothing more than a minor blip on the ever-rising line of growth.¹⁶⁴

Even the “war” between Chicago and New York came to resemble be a minor scuffle by 1988. By the end of the *Time* article, a type of détente was reached. Although portfolio insurance fell out of fashion after the crash, trading index funds remained a profitable. The strategies of Chicago had created wealth. Although some still believed that regulation was needed, or “the heady days of the 1980s bull market will be gone for a long, long time,” a sea change had begun on Wall Street. The spectacular growth leading up to the crash was something to aspire to, not limit. Chicago’s culture was, perhaps, something to emulate. Stated succinctly by Max Chapman, president of New York based investment firm Kidder, Peabody: “Speculation [was] not a dirty word” by 1988.¹⁶⁵

¹⁶⁴ Daniel R. Fischel, “Should One Agency Rule Financial Markets?,” Unpublished Manuscript, CBOT Part 2, Series 3, Box 16, Folder 1.

¹⁶⁵ Koepp, “The War of Two Cities.”

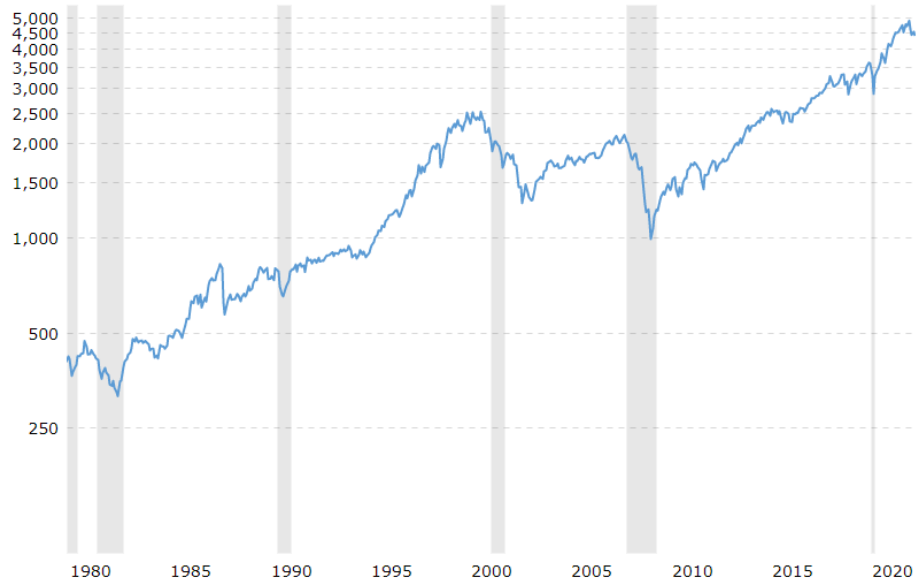


Figure 12. S&P 500 Index, 1980 to 2023¹⁶⁶

¹⁶⁶ “S&P 500 Index - 90 Year Historical Chart – 1980 to 2023,” Macrotrends.net, last accessed February 14, 2023, <https://www.macrotrends.net/2324/sp-500-historical-chart-data>.

Epilogue

Country on FIRE

Financial production continued to lay golden eggs for the next three decades. The American economy, according to all standard metrics, grew and grew. New York and Chicago markets continued to climb, dwarfing the immense gains of the 1980s. In the 1990s, earnings for average Americans grew at a faster rate than the 1980s.¹ The national economy ran a surplus for the first time since 1948.² Congress, H.W. Bush, and Bill Clinton all heeded Leo Melamed's advice, ensuring that "our market accommodate [financial] business" through marquee acts such as repealing Glass-Steagall in 1999, and the Commodity Futures Act of 2000.³

By 1996, the total value of all listed shares in American stock markets surpassed the total value of the GDP.⁴ That same year Federal Reserve Chairman Alan Greenspan replicated his testimony from 1987, stating that stock market valuations exceeded any historical explanation.⁵ Again, the profits of the underlying businesses did not match the valuation of their stocks. However, unlike in 1987, Greenspan saw no reason for concern. Stock market valuations were, in fact, justified. There was no mechanism like portfolio insurance distorting the marketplace. Furthermore, Greenspan asserted that "central bankers need not be concerned if a collapsing

¹ Juliana Menasce Horowitz, Ruth Igielnik, and Rakesh Kochhar, "Most Americans Say There is Too Much Economic Inequality In The U.S., But Fewer Than Half Call It A Top Priority," Pew Research Center, January 9, 2020, <https://www.pewresearch.org/social-trends/2020/01/09/trends-in-income-and-wealth-inequality>.

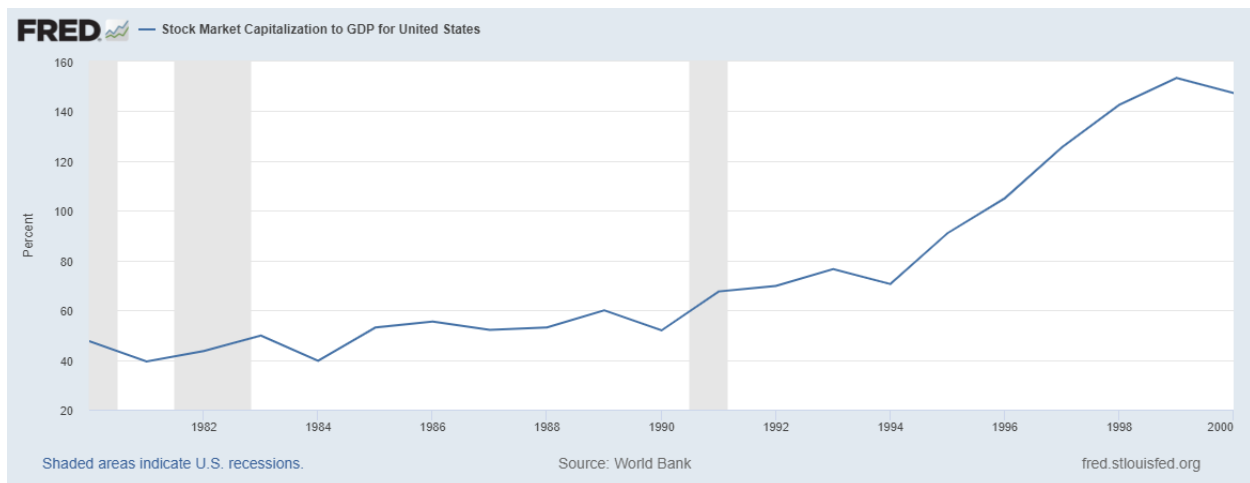
² "The Clinton/Gore Administration: Largest Surplus in History on Track," Clinton Whitehouse Archives, October 13, 2000, https://clintonwhitehouse4.archives.gov/textonly/WH/new/html/Tue_Oct_3_113400_2000.html.

³ U.S. Congress, Senate, Committee on Banking, Housing, and Urban Affairs, *The Turbulence in the Financial Markets Last October, the Functioning of our Financial Markets During that Period, and Proposals for Structural and Regulatory Reforms: Hearings before the Committee on Banking, Housing, and Urban Affairs*, 100th Cong., 2nd sess., February 2, 3, 4, and 5, 1988, Leo Melamed, 282. Joseph E. Stiglitz, *The Roaring Nineties: A New History of the World's Most Prosperous Decade* (WW Norton, 2003).

⁴ "Stock Market Capitalization to GDP For United States," FRED Economic Data, St. Louis Fed, <https://fred.stlouisfed.org/series/DDDM01USA156NWDB#>, last visited February 28, 2023.

⁵ "Remarks by Chairman Alan Greenspan At the Annual Dinner and Francis Boyer Lecture of The American Enterprise Institute for Public Policy Research," Washington, D.C. (December 5, 1996). <https://www.federalreserve.gov/boarddocs/speeches/1996/19961205.htm>.

financial asset bubble does not threaten to impair the real economy, its production, jobs, and price stability. Indeed, the sharp stock market break of 1987 had few negative consequences for the economy.” The Crash of 1987 did no long-lasting damage, so no need to hamper the golden egg.⁶



Stock Market Capitalization to GDP⁷

Greenspan articulated the heart of financial production. Investors’ expectations were justified because investment would, someday, lead to actual material production. Innovation in technology would create profit. This future profit was represented in the high valuation of stocks. Imagination was the center of the economy. Investment in the imagined future, untethered from any historical measurement of the underlying asset, drove wealth creation. Real economic output, in the form of new business, technology, and material goods, would one day appear.⁸

⁶ “Remarks by Chairman Alan Greenspan At the Annual Dinner and Francis Boyer Lecture of The American Enterprise Institute for Public Policy Research,” Washington, D.C. (December 5, 1996). <https://www.federalreserve.gov/boarddocs/speeches/1996/19961205.htm>.

⁷ Federal Reserve Bank of St. Louis, “Stock Market Capitalization to GDP for United States, 1980-2000,” Fred.stlouisfed.org, last visited March 21, 2023, <https://fred.stlouisfed.org/series/DDDM01USA156NWDB#>.

⁸ “Remarks by Chairman Alan Greenspan At the Annual Dinner and Francis Boyer Lecture of The American Enterprise Institute for Public Policy Research,” Washington, D.C. (December 5, 1996). <https://www.federalreserve.gov/boarddocs/speeches/1996/19961205.htm>.

“Speculation is not a dirty word.”⁹ It was economic production, virtuously funding the development of new ideas that would create a better world. Or at least an economically healthy American state. The only threat to financial production was confidence, a form of imagination. If investors believed that the market would turn, they would hold on to their money, causing another crash. Greenspan understood this. Again, taking heed of Melamed’s words, the Federal Reserve Chairman continually gave confidence to financial producers with low interest rates—cheap money—ensuring a continued flow of funds. And, of course, the Fed would continue its role as seen in 1987 as the insurer of the U.S. financial system. Through 1997-98, the Asian financial crisis threatened the confidence of investors. Calamity would surely follow as funds ceased to flow. The Fed once again stepped in, guaranteeing liquidity, and thus ensuring global market stability. For Greenspan, financial production had, like global political struggle, “moved ‘beyond history.’”¹⁰ The model for growth was seemingly unending.

The financial crisis of 2007-2008, and resulting Great Recession, seemed to prove that that financial production had not moved beyond history. Or had it? Mirroring the 1987 Crash, Congress responded with massive infusions of capital to bail out the financial markets. The Fed did its part, enacting new strategies to infuse the market with capital. Markets not only recovered, but surpassed their pre-2007 levels. Again, the American state acted to support the virtuous producers of the American economy. Although faith in this political economy has eroded since 2008—marked by both the growth in popularity of Bernie Sanders on the left, and of course, the election of Trump on the right—the overall political economy remains the same,

⁹ Stephen Koepp, “The War of Two Cities: New York and Chicago Fight a Turf Battle That is Depressing Markets and Stalling Reform,” *Time*, May 30, 1988, available at <http://content.time.com/time/subscriber/article/0,33009,967520-1,00.html>.

¹⁰ “Testimony of Chairman Alan Greenspan An update on economic conditions in the United States Before the Joint Economic Committee, U.S. Congress,” (June 10, 1998), <https://www.federalreserve.gov/boarddocs/testimony/1998/19980610.htm>

locked in a type of zombie politics that continues to support finance above all else, even as inequality and instability rise worldwide.

This dissertation examined how the political economy of financial production was formed in the 1980s. The Volcker Shock marked a moment of historical rupture, ushering in finance capitalism. Over time, speculation was recognized as virtuous as financiers invented a new means of economic growth that remade the moribund industrial economy of the 1970s into one with unending potential. All that was needed to continue this paradigm was to support the new virtuous producers of society.

Current literature works to collapse the Volcker Shock with the rise of the Neoliberal Order. This story constrains our understanding of the era; framing the 1980s as the rise of neoliberalism masks as much as it illuminates as the focus on defining and framing the ideology misses the fundamental change over time in the 1980s. It is true that the actions of Volcker's Federal Reserve under Jimmy Carter carried into the first term of Ronald Reagan to mark a new type of political consensus. However, as this dissertation demonstrates, the end of the New Deal Order and rise of the Neoliberal Order was not an orderly, smooth political transition where a new consensus around free-market thinking automatically spearheaded dramatic change. Instead, confusion reigned throughout the decade.

Financial capitalism must be placed at the center of the story if we are to understand not only the 1980s, but the following decades. By closely examining key moments of crisis throughout Reagan's second term, this dissertation removed the veil that neoliberalism and the Reagan Revolution have placed on the decade. Political decisions, and perhaps most importantly, the rhetoric of free markets, were profoundly influential. But, as we learned, these decisions

often led to unintended consequences as policy collided with the hard truth that the economy simply did not work as it once had.

The politics of the 1980s were framed by financialization. While Reagan successfully implemented landmark legislation and executive actions that have been defined as the shift to neoliberalism, these policies were recognized as failures by the beginning of his second term. As explored in chapter two, the 1981 tax cuts did not work as intended as the country continued to deindustrialize. In fact, the central strategy of the legislation, the Accelerated Cost Recovery Schedule, effectively subsidized American job loss to foreign countries. It was tax reform efforts by the New Democrats that attempted to direct financial investment into the new industries of technology and research that ultimately shaped the sunrise industries of the next forty years. Importantly, the chapter clarified that Reagan Recovery had little to do with any specific strategy, but was rather the result of Volcker lowering interest rates.

Deregulation is central to our understanding of the Reagan Revolution and the resulting Neoliberal Order. However, chapter three examined how deregulation is a multisided action that is not always adherent to an ideology of small government. In the 1980s, Congress acted to deregulated the savings and loan industry in order to save it. There was never a question about the role of the federal government to help promote access to home mortgages for Americans. Instead, bipartisan congressional action removed New Deal era laws that were effectively strangling the industry of financial investment. Deregulation, in the form of the Garn-St. Germain Act, gave S&Ls a new life, resulting in dramatic growth. However, this growth was often in the form of speculation that resulted in empty buildings. Soon after the passage of the 1986 Tax Reform Act, easy financing vanished, creating a second collapse of the S&L industry. Again, Congress acted. However, in a move that directly counters free-market ideology,

congressional action bailed out the S&L industry, elucidating how the federal government continued to act boldly and spend mightily in order to safeguard chosen sectors of the American economy.

The rise of financial production transformed American society. Financiers, like Melamed, created and implemented a new type of capitalist accumulation that gave America monopoly power over the global financial marketplace. Global investment from what “had been separate rivers had suddenly combined to become oceans” washed into American markets.¹¹ As outlined in chapter four, financiers created new products to entice the currents of capital into their markets. The expected future return on investment flowed to the present, creating ever higher valuations, thus spurring ever more investment. These new financialized products created previously unimaginable wealth. What we currently understand as separate events—the Reagan Recovery, the Great Bull Market of the 1980s, and the New Economy of the 1990s—are, in fact, the result of financial production.

Placing financial production at the center of the 1980s clarifies how the political economy transformed in the decade. Political rhetoric was transformed with an embrace of “free markets,” but actual legislation continued to use the tools of the New Deal. Chapter four investigated how the American state, in the form of regulatory agencies such as the Commodity Futures Trading Commission, acted to create these markets, illustrating the continued role and power of active federal governance.

Chapter five continues this thread. During the chaotic days of October 1987, the Federal Reserve directly intervened into the economic sphere. The key political transformation of the era was not some type of free market consensus, but rather, that government actions supported the

¹¹ Leo Melamed and Bob Tamarkin, *Escape to the Futures* (John Wiley & Sons, 1996), 357.

supply-side of the economy over the demand side. This transformation is the beating heart of financial production policy making.

Despite the dramatic changes ushered in by the Volcker Shock and financialization, the virtuous producer ideal remained fundamental in American culture. As explored in chapter one, after farm bankruptcies hit crisis levels in 1985, President Reagan followed through with his free-market agenda and asserted that “the government cannot ‘bail out every farmer hopelessly in debt’ . . . [with a] bailout that would add billions to the deficit.”¹² However, farmers were not recognized by the public as mere market actors; they were paramount virtuous producers of American society. Farming was “an act of total commitment to people.”¹³ Denying them government aid was akin to allowing “the last remnants of our great cultural heritage to disappear.”¹⁴ Consequently, public support for Reagan’s free-market ethos disappeared when it threatened this pillar of American society.

The Farm Crisis also illustrates how a commodity bubble functions. Cheap loans induced investment and overproduction of a global commodity: midwestern grain. Eventually the global market was saturated, driving down the price of grain, causing financial collapse and debt default for millions of mid-level American farmers. As explored in the following chapters, this dynamic replayed itself again and again through the financial markets of the 1980s. However, a key transformation took place as finance markets transformed what a commodity was. Specifically, we learned how Wall Street itself was made into a commodity on the Chicago futures exchanges.

¹² George de Lama and Lea Donosky, “Reagan Kills Farm Bill: No ‘Bailout’ for Farmers Deep in Debt,” *Chicago Tribune*, March 7, 1985.

¹³ Sissy Spacek, Live Aid Broadcast, September 22, 1985.

¹⁴ Jessica Lange, Live Aid Broadcast, September 22, 1985.

Instead of cheap loans, the oceans of foreign and domestic capital flowed into these markets, raising the price of the financialized commodity beyond any rational market expectation.

Financiers like Leo Melamed led the creation of financial futures, creating the new model of financial production, thus earning the mantle of virtuous producer. The line between imagined and material evaporated as the futures market switched from commodities that you once had to grow, such as wheat, to bundled derivatives that speculated on the future value of Wall Street itself. Congress recognized the utility of these new products and remade century-old laws in order to support and expand financial production. Again, the federal government directly influenced the marketplace in order to support the new virtuous producers of the American economy.

The Crash of 1987 represents how the financialized economy creates wealth, and how this wealth creation is vulnerable to sudden collapses. Leo Melamed argued that any reform and substantial regulation on American financial markets would effectively kill the “golden egg” of financial production, creating a dynamic mirroring deindustrialization where foreign markets would simply replace the Chicago and New York exchanges. Congress agreed with Melamed, ignoring the calls for reform.

The political economy of financial production continued for decades. The imagined future growth of an underlying commodity—whether that be Wall Street, internet start-ups, or mortgage-backed derivatives—drove the economy. Speculation funneled investment into the next hot new idea. Eventually each growth period became untethered from any material, and thus, real-world productive gains. Then the bubble burst. However, wealth generation during the

period of growth was so great that Congress declined to enact any meaningful reform to the system.

More work needs to be done if we are to fully understand how and why financial production remained a durable political economic system. This dissertation explored the uneven early stages of financial production. Further examination on how financial production grew from its disjointed beginnings in the 1980s to dominate the political economy throughout the 1990s, and how this changed American culture, is needed. Historians exploring these issues should focus on two interconnected questions.

The first examines how the connection between the Chicago-based futures exchanges and the New York Stock Exchange continued to develop through the 1990s. As we learned, the Chicago futures exchanges made the NYSE a commodity using index funds futures, creating new means of wealth generation, but also increasing speculation that led to the Crash of 1987. Congress refused to heavily regulate the industry. Instead, the derivative market continued to grow almost unchecked, combining with new internet-based companies resulting in enormous economic growth. However, this development ultimately led to the Dot.com bust. Analyzing the archives of both the Chicago Mercantile Exchange and the Chicago Board of Trade may illuminate how the financial actors created and understood these new products. Furthermore, an examination of Congress and the Clinton administration will reveal how the political economy of financial production motivated the now infamous deregulatory scheme imbedded in The Commodity Futures Modernization Act of 2000.

Secondly, historians must explain how everyday Americans came to understand themselves as investment bankers. Historically, most Americans first experienced capitalism through the household. Thomas Jefferson's yeoman farmer was a model of virtuous

production—an independent man who provided to his family and community—for much of American history. This ideal connects to the wide-spread notion that American households were their own private bank. Much like the idealized farmer of chapter one, Americans created wealth by investing in their home. They then used this new asset to borrow against in order to partake in the consumer economy. Labor income was replaced by access to credit financed through the household.

As we learned in chapter three, the Savings & Loan Crisis provides the spark that led to the financialized household. Real estate remains the pivotal link between Americans and the financialized heart of the U.S. economy. The classic thirty-year single-family home mortgage remained a safe investment through the 1980s.¹⁵ In the next decades, the federal government further encouraged home ownership to, as George W. Bush Jr. stated, create an “ownership society” based on property, not income.¹⁶ Home ownership was recognized as a virtuous endeavor; one that should be open to all Americans, no matter their income.

Speculation through investment and credit allowed average Americans direct access to financial production. The home became more than a building—it became a primary means for wealth generation, allowing Americans to become financialized producers like Leo Melamed. In theory, their asset—the home—grew in value over time. This not only increased the personal wealth of the average American investor, but also their neighborhoods, community, and the nation. The act of speculating through real estate, then, became a form of financial virtuous

¹⁵ Andrew S. Carron, *Studies in the Regulation of the Economy: The Plight of the Thrift Institutions* (The Brookings Institution, 1982), 21.

¹⁶“This Administration will constantly strive to promote an ownership society in America. We want more people owning their own home. It is in our national interest that more people own their own home. After all, if you own your own home, you have a vital stake in the future of our country.” George W. Bush, “Remarks on Signing the American Dream Downpayment Act,” (speech, December 16, 2003), WhiteHouse.Archives.gov, <https://georgewbush-whitehouse.archives.gov/infocus/achievement/chap7.html>.

production. Through the household, Americans created wealth, propelled the economy, and cemented the new political economy based on financial speculation.

The financial crisis of 2007/8 and resulting Great Recession marks an end to the unquestioned dominance of the financial production model. The mortgage crisis damaged the virtue of financial production as investigations revealed that investment banks essentially had hands on both ends of the scale, issuing both mortgages and mortgage-backed securities from the same loan. The desire for growth outpaced the number of Americans who would normally qualify for mortgages. In response, mortgages began to be issued to Americans with “no income, no jobs, nor assets,” creating a predatory lending system that targeted vulnerable Americans to ensure continued financial growth for investment banks.¹⁷

The financial collapse of 2007/8 follows the exact model of a financial commodity bubble analyzed throughout this dissertation, though at a level previously thought unimaginable. However, it was the first time that the dynamics of financial production were exposed to the average person. With the economy on the brink of collapse, the federal government moved to bail out the largest investment firms under the banner of “too big to fail”—directly mirroring the movement to save ailing S&Ls in the late 1980s.¹⁸ After including tax cuts to appease congressional Republicans (again demonstrating the party’s singular fixation with tax cuts after 1986), the House passed the Trouble Asset Relief Program (TARP). This program first allowed the Treasury to buy up to \$700 billion of toxic assets, modified to directly give capital to banks.

¹⁷ Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* (BN Publishing, 2011); Martin Wolf, *The Shifts and the Shocks: What We’ve Learned—and Have Still to Learn—from the Financial Crisis* (Penguin Press, 2014).

¹⁸ Andrew Ross Sorkin, *Too Big to fail: The Inside Story of How Wall Street and Washington Fought to Save the Financial System—and Themselves* (Penguin Press, 2010).

The Federal Reserve too matched the dynamic of 1987, but with ever more creative ideas. Strategies included “Commercial Paper Funding Facility” (CPFC) and the “Primary Dealer Credit Facility” (PDCF), both asserting the Fed as the lender, and then buyer, of last resort. These actions assuaged the fears of panicked investors, and by January 2009, the crisis shifted from collapse to slump. But the economy survived.¹⁹

The actions of Congress and the Fed to save the financial system fundamentally transformed American politics. The perceived success of the “ownership society” was quickly replaced by a moment best articulated by Karl Polanyi. Over seventy years ago, Polanyi surveyed the world and found a situation very similar to the financial meltdown of 2007/8. In the 1930s, massive wealth concentration and economic collapse ravaged countries across the West. Citizens responded by supporting politics that they thought would protect them from the worst ravages of profit-seeking. This double movement—laissez faire capitalist growth and people’s need to protect themselves from a ruthless marketplace and poverty—became a key insight for his influential work, *The Great Transformation*.²⁰

Politics after 2008 replicate this double movement. Members of the Republican party were appalled by TARP. In their mind, investment firms were the same as the bankrupt farmers in 1985. Perhaps unaware of the repeated bailouts throughout the 1980s, they nevertheless agreed with Reagan’s sentiment that the government should not bail out investors in debt, incurring millions to the national deficit. The fact that the federal government not only made this

¹⁹ Perry Mehrling, *The New Lombard Street: How the Fed Became the Dealer of Last Resort* (Princeton University Press, 2010); Eric A. Posner, *Last Resort: The Financial Crisis and the Future of Bailouts* (Chicago University Press, 2018); Neil Irwin, *The Alchemists: Three Central Bankers and a World on Fire* (Penguin Press, 2013); Jonathan Levy, *Ages of American Capitalism: A History of the United States* (Random House, 2021), 702-31.

²⁰ Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (1944; Beacon Press, 2001).

bailout money back, but turned a slight profit, did not wash away the stink of corruption.²¹ After the election of President Obama, this rancor manifested in the Tea Party, which actively moved to block almost any federal spending.²²

For many conservative Americans, the financial collapse and bailouts proved that the American state was corrupt. Failure to address fundamental changes in the economy since the mid-1980s led to endemic poverty in rural America. New reports have exposed that the mortality rate for the rural white population has increased in the past thirty years.²³ Chronic drug and alcohol abuse is rampant. An overall feeling of nihilism, betrayal, and isolation have led to wide support for Donald Trump who offered, like Reagan, to “Make America Great Again,” through untenable promises of resurrecting mining, manufacturing, and other aspects of a long-gone industrial society, all underlined by a white supremacist mindset. The industrial-era virtuous producer ideal reemerged, filled with rancor and vengeance. Trump effectively tapped into the vacuum left by the destruction of the financial virtuous producer, stating that he “want[s] to be so greedy for our country. I want to take back money.”²⁴ He continuously promoted himself as a successful businessman, effectively using Romney’s “job creator” rhetoric to cast himself as the paradigm of intelligence and virtue.²⁵

²¹ “As of October 31, 2016, cumulative collections under TARP, together with Treasury’s additional proceeds from the sale of non-TARP shares of AIG, exceed total disbursements by more than \$7.9 billion.” See “Troubled Assets Relief Program (TARP),” U.S. Department of the Treasury, last visited March 21, 2023, <https://home.treasury.gov/data/troubled-assets-relief-program>.

²² Theda Skocpol and Vanessa Williamson, *The Tea Party and the Remaking of Republican Conservatism* (Oxford University Press, 2012).

²³ Anne Case and Angus Deaton, *Deaths of Despair and the Future of Capitalism* (Princeton University Press, 2020); Joel Achenbach and Dan Keating, “A New Divide in American Death,” *Washington Post*, April 10, 2016, http://www.washingtonpost.com/sf/national/2016/04/10/a-new-divide-in-american-death/?utm_term=.0e5950699e77.

²⁴ Bradford Richardson, “Trump: ‘I’m Very Greedy,’” *The Hill*, January 9, 2016, <https://thehill.com/blogs/ballot-box/gop-primaries/265335-trump-im-very-greedy/>.

²⁵ Karen Tumulty, “How Donald Trump Came Up With ‘Make America Great Again,’” *Washington Post*, January 18, 2017, https://www.washingtonpost.com/politics/how-donald-trump-came-up-with-make-america-great-again/2017/01/17/fb6acf5e-dbf7-11e6-ad42-f3375f271c9c_story.html?utm_term=.cf056e1e7b4b; Zack Beauchamp, “‘He’s Not Hurting the People He Needs to Be’: A Trump Voter Says the Quiet Part Out Loud,” *Vox.com*, January 8,

The financial collapse and Great Recession also profoundly changed the American left. Occupy Wall Street began as a series of demonstrations against Wall Street bailouts. Protestors asked why Congress had helped those who already had so much and left normal Americans mired in debt and bankruptcy. The emerging rhetoric of the “one percent” put into sharp focus how wealth inequality created by the political economy of financial production dominated the nation. Bernie Sanders, Elizabeth Warren, and younger House Democrats such as Alexandria Ocasio-Cortez, Ilhan Omar, and Cori Bush all called to raise taxes on the wealthy, increase social welfare programs, and create a Green New Deal that would address climate change and inequality.²⁶

Both political factions recognize the central shortcoming of financial production. What, exactly, is the point of wealth creation if it does not benefit the people? While the right places blame on those who have the least amount of power, leading down a dangerous spiral of culture war inanities, the left began to take some action at reforming the system. Yet, political action on a national level remains surprisingly unchanged. Though the virtue of financial production is greatly diminished, its politics lives on in a zombie-like state. Financial markets continue to grow, creating ever more absurdities as illustrated by crypto currency. Homeowners resist

2019, <https://www.vox.com/policy-and-politics/2019/1/8/18173678/trump-shutdown-voter-florida>; Simon Clark, “How White Supremacy Returned to Mainstream Politics,” *Center for American Progress*, July 1, 2020, <https://www.americanprogress.org/article/white-supremacy-returned-mainstream-politics/>; Sarah McCammon, “From Debates Stage, Trump Declines to Denounce White Supremacy,” *NPR*, September 30, 2020, <https://www.npr.org/2020/09/30/918483794/from-debate-stage-trump-declines-to-denounce-white-supremacy>; Keeanga-Yamahtta Taylor, “The Bitter Fruits of Trump’s White-Power Presidency,” *New Yorker*, January 12, 2021, <https://www.newyorker.com/news/our-columnists/the-bitter-fruits-of-trumps-white-power-presidency>.
²⁶ Tim Adams, “Bernie Sanders: ‘Oligarchs Run Russia. But Guess What? They Run the US As Well,’” *Guardian*, February 19, 2023, <https://www.theguardian.com/us-news/2023/feb/19/bernie-sanders-oligarchs-ok-angry-about-capitalism-interview>; Annie Lowrey, “The Economics of Occupy Wall Street: The protesters say the top 1 percent of Americans have gotten too rich. Are they right?,” *Slate*, October 5, 2011, <https://slate.com/business/2011/10/occupy-wall-street-says-the-top-one-1-percent-of-americans-have-gotten-too-rich-are-they-right.html>; Michael Levitin, “Occupy Wall Street Did More Than You Think: The Movement Itself has Mostly Disappeared. But 10 Years Later, Its Legacy is Everywhere,” *The Atlantic*, September 14, 2021, <https://www.theatlantic.com/ideas/archive/2021/09/how-occupy-wall-street-reshaped-america/620064/>; Lisa Friedman, “What Is the Green New Deal? A Climate Proposal, Explained,” *New York Times*, February 21, 2019, <https://www.nytimes.com/2019/02/21/climate/green-new-deal-questions-answers.html>.

changes to building codes in order to protect their property values, and thus their ability to create wealth.²⁷ The markets grow as inequality rises and American society continues to fracture.²⁸

This dissertation has argued that financialization fundamentally transformed the American political economy. We must recognize the centrality of this change in order to create new political imaginations that embrace the possibilities of financial production. The wealth creation of the last forty years has been nothing less than spectacular. However, wealth disbursement has been massively unequal.²⁹ As I have argued, this dynamic is explained by Congress's commitment to supporting financiers as virtuous producers, thus tying protective actions to the supply side of the economy. Labor—meaning average working Americans—could only access financial production through the ownership of assets, commonly in the form of real estate or stocks. This dynamic has effectively cut off most Americans from the golden egg of financial production, creating dire conditions that have led to political fragmentation.³⁰

But this does not need to be the case. Speculation is often recognized as dirty word, creating images of gambling and wanton greed. The economic collapses of 1987 and 2007/8 reinforce this understanding. However, speculation is also an act of hope, centered on believing in a future of increased prosperity, and investing in that vision. Financial production can offer a way to radical economic equality. In order to do so, the federal government must work to invest

²⁷ Lisa Adkins, Melinda Cooper, and Martijn Konings, "Class in the 21st century: Asset Inflation and the New Logic of Inequality," *Environment and Planning A: Economy and Space*, Vol. 53, no. 3 (2021), 548–572, <https://doi.org/10.1177/0308518X19873673>; Steven Brill, "How Baby Boomers Broke America," *Time*, May 17, 2018, <https://time.com/magazine/us/5280431/may-28th-2018-vol-191-no-20-u-s/>; Alex Yablon, "The Great Boomer Bottleneck: Their Greed Destroyed the Economy—and Now Millennials and Gen Z are Paying the Price," *Business Insider*, March 1, 2023, <https://www.businessinsider.com/boomer-greed-ruined-economy-gen-z-millennials-labor-shortage-inflation-2023-3>.

²⁸ Press Release, "SEC Charges Samuel Bankman-Fried with Defrauding Investors in Crypto Asset Trading Platform FTX," U.S. Securities and Exchange Commission, December 13, 2022, <https://www.sec.gov/news/press-release/2022-219>.

²⁹ Peter H. Lindert and Jeffrey G. Williamson, *Unequal Gains: American Growth and Inequality since 1700* (Princeton University Press, 2016), 220.

³⁰ Lisa Adkins, Melinda Cooper, and Martijn Konings, *The Asset Economy* (Policy Press, 2020).

in the people. As we have seen, the virtuous producer ideal is a rather malleable concept; it does not need to be remained tied to financiers.

Perhaps the Covid-19 pandemic can point a way forward. Throughout the pandemic, frontline workers were portrayed as heroes who selflessly worked to provide to the general welfare, all while exposed to higher rates of infection and death.³¹ More importantly, these workers are mostly women, immigrants, and people of color—Americans who were denied a place in the power structure of the postwar New Deal Order.³² Rather than limit the nation’s response to a symbolic “thank you” to workers who suffered to provide during one of the deadliest moments of American history, the virtuous producer ideal can enter the twenty-first century to again push back against free market fundamentalism and facilitate the moral justification to enact social and welfare policies that focus on income and equality to better the material condition of millions of Americans.

Financial production offers a path to a world beyond scarcity. However, since the 1980s, this has been used to benefit only a small subset of people. Political reform, centered on reorienting the virtuous producer, can be used to benefit all Americans. Including service work into this cultural ideal is an important mission of our era. This is no easy task. However, the reward would be immeasurable as the rising tide of speculation, or better put, the rising tide of hope, would finally be used to lift all boats.

³¹ “Morbidity and Mortality Report, COVID-19-Associated Hospitalizations Among Health Care Personnel – COVID – Net, 13 States, March 1 – May 31, 2020,” *Centers for Disease Control and Prevention*, October 30, 2020, <https://www.cdc.gov/mmwr/volumes/69/wr/mm6943e3.htm>; Jen Christensen, “About 20% of Grocery Store Workers had Covid-19, and Most Didn’t Have Symptoms, Study Found,” *CNN*, October 29, 2020, <https://www.cnn.com/2020/10/29/health/grocery-workers-increased-covid-19-risk-wellness/index.html>; Christina Jewett and Liz Szabo, “Coronavirus is Killing far more US Health Workers Than Official Data Suggests,” *Guardian*, April 15, 2020, <https://www.theguardian.com/us-news/2020/apr/15/coronavirus-us-health-care-worker-death-toll-higher-official-data-suggests>.

³² Gabriel Winant, *The Next Shift: The Fall of Industry and the Rise of Health Care in Rust Belt America* (Harvard University Press, 2021).

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<https://www.congress.gov/bill/97th-congress/house-bill/4242>.
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