

A Political Economy of Oligarchy: Winner-take-all ideology, superstar norms, and the rise of the 1%
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Abstract

The rise of the 1% was the result of interaction among several systems. It was not technologically determined, though technology helped implement and amplify some of its elements. It was not driven by a right wing conspiracy of elite businesses, although business lobbying played an important role at critical junctures. It certainly built on the intellectual ascendance of neoliberalism, but also emerged from left wing skepticism about regulation and consumer-oriented drives for deregulation. Changes in popular culture that tied social status to money more directly than had typified the prior three decades, particularly perceptions of superstars, their importance, and the legitimate levels of compensation they could expect played a critical role. The dynamic reflected both intended and unintended consequences. And it introduced dynamics that likely reduced productivity growth, rather than enhancing it. The story is not one of skills and technology leading to winner-take-all markets that lifts all boats as long as we have enough redistribution. It is a story of power and rent extraction by those who were in the position to take advantage of broad social and intellectual dynamics, political shifts, and organizational transformations to capture the overwhelming majority of the gains from market production.

Throughout the era of oligarchic capitalism claims that technology was the central cause of rising inequality—skills-biased technical change in the broad economy, and winner-take-all markets at the top of the income distribution—were the dominant explanation in economics and policy circles. Arguments about technology, efficiency, and growth served to legitimate growing inequality and limit the range of policy responses to the massive extraction of value by a managerial and financial class at the expense of working families, consumers, fiscally constrained communities and government services, and even saver-investors and their retirement security. The economic insecurity that the policies so justified wrought for the majority of the population has now bled into political instability as large numbers of voters across the most established democratic market societies are turning to xenophobic finger-pointing to explain why they are on the losing end of an economy that fails to provide them with security and paths for growth.

A political economy of the rise of oligarchic capitalism suggests that the radical shift from an era of high productivity growth and lower inequality to a period of slower productivity growth, widespread economic insecurity, and extreme concentration of wealth reflected a shift in power across several dimensions—knowledge, institutions (politics, law, organizational practice, social norms, markets), and technology. Many excellent studies have focused on causes other than technology—union decline, globalization, the rise of neoliberalism, financialization, and the rise of organized business in politics have been primary. Each focused on one or two dimensions of the change, while recognizing the importance of others. Here I combine a synthesis of these approaches and emphasize the the feedback mechanisms and interactions among these changes, with a particular an emphasis on ideology—the way we frame our understanding of what is going on and how the world works—and how it influenced the most illusive of institutions: social norms.

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Economic inequality has increased since the 1970s throughout most advanced economies,¹ but the levels and pattern of inequality differs significantly from country to country, and nowhere has income inequality in particular increased as sharply as it has in the United States.² The share of income going to the top 1% reached an inflection point and began to rise around 1980, while broader-based wage stagnation at the median began during the Great Inflation of the 1970s. The median American worker saw more wage growth in the six years from 1967 to 1973 than in the forty years since then.³

For the past quarter of a century the most widely accepted explanation for rising inequality among policymakers and economists was technological change. It included two distinct lines of work: skills-biased technical change (SBTC)⁴ and winner-take-all markets.⁵ Both lines of argument interpreted the radically changed patterns of income inequality as reflecting relative productivity of different types of workers, given a changed technological environment. By “naturalizing” the process to a technological and market dynamic, rather than a politically-addressable institutional dynamic, these explanations legitimated the inequality of market outcomes and limited the range of relevant policy responses to education or post-market redistribution. If we wanted innovation, growth, and productivity, the technology-centered explanations implied, we must improve education and make everyone as good as the deserving educated who are making so much more money. If we wanted the best people innovating and managing our economy, rather than to prop up mediocrity, we must accept that under the new conditions some winners at the very top will get incredibly rich rewards. Together, SBTC and winner-take-all economics provided a legitimating framework for the massive redistribution of wealth from the bottom 90% of wage earners to the top one percent. Throughout most of this period, SBTC was subject to sustained empirical criticism,⁶ but its dominance was preserved despite

1Divided We Stand and OECD, *Divided We Stand, An Overview of Growing Income Inequalities in OECD Countries*. (OECD. Retrieved from <http://www.oecd.org/els/soc/49499779.pdf>, 2011), http://www.sabanciuniv.edu/HaberlerDuyurular/Documents/S_/2012/47987-1355919648-DwS_overview.pdf.

2Thomas Piketty and Emmanuel Saez, “Income Inequality in the United States 1913-1998,” *Quarterly Journal of Economics* 1 (2003), <http://www.jstor.org/stable/pdf/25053897.pdf>; Thomas Piketty and Emmanuel Saez, “Inequality in the Long Run,” *Science* 344, no. 6186 (2014): 838–843; Thomas Piketty, Emmanuel Saez, and Stefanie Stantcheva, “Optimal Taxation of Top Labor Incomes: A Tale of Three Elasticities” (National Bureau of Economic Research, 2011), <http://www.nber.org/papers/w17616>; Facundo Alvaredo et al., “The Top 1 Percent in International and Historical Perspective,” *Journal of Economic Perspectives* 27, no. 3 (August 2013): 3–20, doi:10.1257/jep.27.3.3.

3Lawrence Mishel et al., *The State of Working America* (Cornell University Press, 2012), http://books.google.com/books?hl=en&lr=&id=WdM77z0HUcAC&oi=fnd&pg=PR9&dq=%22school%E2%80%93or+college-educated+workers+and,+consequently,+the+median%22+%22Unfortunately,+the+problem+is+not+being%22+%22inequality+in+the+United+States+has+grown+sharply+over+the+last+few%22+&ots=bTmghisZ-p&sig=ddWRBUxeT0Z3MhN9stS3_37pj5s. (Table 4.1).

4L. F. Katz and K. M. Murphy, “Changes in Relative Wages, 1963-1987: Supply and Demand Factors,” *The Quarterly Journal of Economics* 107, no. 1 (February 1, 1992): 35–78, doi:10.2307/2118323; Claudia Goldin and Lawrence F. Katz, *The Race between Education and Technology* (Cambridge, Mass.: Belknap Press, 2010); Autor, H. DAVID, LEVY FRANK, and J. MURNANE RICHARD, “The Skill Content of Recent Technological Change: An Empirical Exploration,” *Quarterly Journal of Economics* 118 (2003): 4.

5Sherwin Rosen, “The Economics of Superstars,” *American Economic Review* 71, no. 5 (December 1981): 845–58; Robert H. Frank and Philip J. Cook, *The Winner-Take-All Society: Why the Few at the Top Get So Much More Than the Rest of Us*, Reprint edition (New York, NY: Penguin Books, 1996).

6Lawrence Mishel and Jared Bernstein, “Technology and the Wage Structure: Has Technology’s Impact Accelerated Since the 1970s?,” SSRN Scholarly Paper (Rochester, NY: Social Science Research Network, February 19, 1999), <http://papers.ssrn.com/abstract=139586>; LAWRENCE MISHEL, HEIDI SHIERHOLZ, and JOHN SCHMITT, “DON’T

the need for repeated revisions of its core claims to fit changes in wage patterns from decade to decade.⁷

Throughout this period there have been competing explanations focused on institutions and politics, rather than market dynamics and technology, as the primary drivers of inequality and economic insecurity. Freeman⁸ and Card and others⁹ showed that union decline offered a significant explanation of inequality, in particular among men.¹⁰ It did so directly through loss of economic bargaining power over wages, but also through a loss of influence on social norms surrounding compensation¹¹ and loss of political power in the face of increasingly organized business interests.¹² In the most comprehensive listing of discrete institutional interventions that contributed to rising inequality, Mishel and coauthors argue that inequality patterns for men and women, in the bottom, middle, and top of the income distribution responded to a diverse range of policy choices—from fiscal and monetary policies that influenced the demand for labor and hence influenced market bargaining power, through legal changes that influenced levels of unionization and minimum wages (which influenced in particular inequality among women)¹³, to immigration and trade terms.¹⁴ Hacker and Pierson, in *Winner-Take-All Politics*, tied several of these discrete institutional changes to a fundamental shift in the political strategy of the U.S. Chamber of Commerce and the rise of the Business Roundtable—more generally, the rise of “Organized Business” at the expense of Organized Labor.¹⁵ These arguments received powerful support from the fact that inequality patterns in general,¹⁶ and specific elements of wages and labor structure like executive compensation¹⁷ or the prevalence of non-standard work arrangements and its impact on labor income inequality¹⁸ differed substantially

- BLAME THE ROBOTS,” 2013, http://mercury.ethz.ch/serviceengine/Files/ISN/173732/ipublicationdocument_singledocument/addd55e0-c679-4c1b-b9a0-87f301a25389/en/technology-inequality-dont-blame-the-robots.pdf.
- 7Daron Acemoglu and David Autor, “What Does Human Capital Do? A Review of Goldin and Katz’s *The Race between Education and Technology*,” *Journal of Economic Literature* 50, no. 2 (June 2012): 426–63, doi:10.1257/jel.50.2.426; David H Autor and David Dorn, “The Growth of Low-Skill Service Jobs and the Polarization of the US Labor Market,” *American Economic Review* 103, no. 5 (August 2013): 1553–97, doi:10.1257/aer.103.5.1553.
- 8Richard B. Freeman, “Unionism and the Dispersion of Wages,” *Industrial & Labor Relations Review* 34, no. 1 (1980): 3–23.
- 9David Card, Thomas Lemieux, and W. Craig Riddell, “Unions and Wage Inequality,” *Journal of Labor Research* 25, no. 4 (2004): 519–559.
- 10L. Mishel, J. Schmitt, and H. Shierholz, “Wage Inequality: A Story of Policy Choices,” *New Labor Forum* 23, no. 3 (September 1, 2014): 26–31, doi:10.1177/1095796014544325; Robert J. Gordon and Ian Dew-Becker, “Controversies about the Rise of American Inequality: A Survey” (National Bureau of Economic Research, 2008), <http://www.nber.org/papers/w13982>.
- 11Bruce Western and Jake Rosenfeld, “Unions, Norms, and the Rise in US Wage Inequality,” *American Sociological Review* 76, no. 4 (2011): 513–537.
- 12Jacob S. Hacker and Paul Pierson, *Winner-Take-All Politics: How Washington Made the Rich Richer and Turned Its Back on the Middle Class*, 1st Simon & Schuster hardcover ed (New York: Simon & Schuster, 2010).
- 13Gordon and Dew-Becker, “Controversies about the Rise of American Inequality.”
- 14L. Mishel, J. Schmitt, and H. Shierholz, “Wage Inequality: A Story of Policy Choices,” *New Labor Forum* 23, no. 3 (September 1, 2014): 26–31, doi:10.1177/1095796014544325.
- 15Hacker and Pierson, *Winner-Take-All Politics*, 2010.
- 16Facundo Alvaredo et al., “The Top 1 Percent in International and Historical Perspective,” *Journal of Economic Perspectives* 27, no. 3 (August 2013): 3–20, doi:10.1257/jep.27.3.3; Stand and OECD, *An Overview of Growing Income Inequalities in OECD Countries*.
- 17Stephen Bryan, Robert Nash, and Ajay Patel, “Law and Executive Compensation: A Cross-Country Study,” *Journal of Applied Corporate Finance* 23, no. 1 (March 2011): 84–91, doi:10.1111/j.1745-6622.2011.00317.x.
- 18Jean-Marc Fournier, Isabelle Wanner, and Isabell Koske, “Less Income Inequality and More Growth – Are They Compatible? Part 2. The Distribution of Labour Income,” OECD Economics Department Working Papers, (January 10,

among countries at the same technological frontier and similarly integrated into the global free trade system. These lines of criticism reflect a fundamentally different understanding of how labor markets operate. They are elements of a political economy—the study of how power shapes production and distribution in society. Most of this work focused on discrete legal or political interventions—changes in formal institutions or the politics of changing these formal institutions. Other work focused on ideas, in particular, the rise of neoliberalism as an ideology and its translation into practical legal institutional interventions that supported inequality.¹⁹

Whether we believe that high income inequality and broadbased economic insecurity are a result of technological and market dynamics operating independently of political and social institutions, or whether they are the result of sustained political decisions and institutional changes has profound impact for how we think about addressing present and future economic insecurity, and the political instability associated with the rise of an oligarchic class. As long as we understand markets as more-or-less efficient if left to their own devices, and technology as marching to the beat of its own drum, more-or-less independent of social and institutional processes, the range of policy choices open to address inequality is constrained. If we understand that markets are noisy, and offer quite a bit of play in the joints for either rent extraction or more egalitarian social division; and if we understand technology to be endogenous to the social practices into which it is received, as most studies of technology and society do, then there is much more, on many more dimensions, that we can do, as societies and polities, to reap the benefits of technological development and market choices while sustaining broadbased economic security and avoiding the corrosive political effects of a rising oligarchy.

Winner-Take-All economics in particular has a strong resonance in Silicon-Valley centered political communities, both libertarian and liberal,²⁰ and the sense that technology is an exogenous force underlies much of contemporary debate over the future of work, automation, and platforms across the political spectrum. Understanding the past as a product of a political economy that created and sustained oligarchic politics and ideology—a politics and frame of mind that supported extraction of rents by a small managerial, financial, and professional class across the partisan divide at the expense of a broad working and middle class—suggests that the challenges of the future are not technology or market-based. They have to do with how we understand the world, and how its politics and institutions are organized.

In this essay I offer two contributions to the literature on the political economy of inequality. First, in several lines of work, some of the leading economists who work on inequality or executive pay, for example, point to, but do not explore, social norms as the residual likely locus of the change.²¹ Here I offer a study of how social norms about superstar salaries emerged over the course of the 1970s,

2012), http://www.oecd-ilibrary.org/economics/less-income-inequality-and-more-growth-are-they-compatible-part-2-the-distribution-of-labour-income_5k9h2975rhhf-en.

19Daniel Stedman Jones, *Masters of the Universe: Hayek, Friedman, and the Birth of Neoliberal Politics*, Updated edition with a New Foreword edition (Princeton, NJ: Princeton University Press, 2014); Steven Michael Teles, *The Rise of the Conservative Legal Movement: The Battle for Control of the Law*, Princeton Studies in American Politics: Historical, International, and Comparative Perspectives (Princeton, N.J: Princeton University Press, 2008).

20Gregory Ferenstein 11 08 15 11:00 AM, “The Politics of Silicon Valley,” *Fast Company*, November 8, 2015, <https://www.fastcompany.com/3053318/the-politics-of-silicon-valley>.

21Piketty and Saez, “Inequality in the Long Run”; Lucian Bebchuk and Jesse Fried, *Pay without Performance: The Unfulfilled Promise of Executive Compensation*, 1. Harvard Univ. Press paperback ed (Cambridge, Mass.: Harvard Univ. Press, 2006); Bengt Holmstrom and Steven N. Kaplan, “Corporate Governance and Merger Activity in the US: Making Sense of the 1980s and 1990s” (National bureau of economic research, 2001), <http://www.nber.org/papers/w8220>.

how these norms made status and money fully convertible into each other, and how they fueled both status competition at the top of the income distribution, and a “keeping up with the Jones’s” dynamic that likely impacted people further down the food chain from the top CEOs. In 1968, Karim Abdul Jabar still thought a bidding war over his services “degraded the representatives of the N.B.A. and the A.B.A.”²² By 1976, Barbara Walters already found legitimation both in the million-dollar sums paid athletes, and the bidding war between ABC and NBC was her source of legitimation for taking a million dollar salary despite her concern that people would think that if you make that kind of money “you can't be pure and can't do justice to the news.”²³ This broad shift in social norms was also reflected in elite expectations and norms in the business profession, as a superstar culture among CEO’s replaced the experienced company man, and as that shift at the top of the food change quickly worked its way down to regional “merchandising executives who can give a store directional impact...”²⁴ These cultural changes were complemented by academic theory, in particular agency theory and the shareholder value movement, that further justified and legitimated compensation models and levels that were entirely novel in 1980. That part of the shift in elite culture is, in turn, intimately link to the literature on the rise of neoliberalism during and after the Great Inflation of the 1970s. But that cultural shift only operates in conjunction with political, institutional, and organizational changes that took the new cultural fascination with superstars and injected them into a newly deregulated marketplace, particularly financial markets, where the politics of deregulation were as important as the cultural changes in converting the cultural change into actual oligarchic practice.

The second contribution of the essay is to combine diverse story lines, mostly that others have told, some (like the consumer-worker political split) that I sketch here, into an integrated systems story. Power shifts across many dimensions, and changes in the institutions or strategies of diverse actors feed back into each other to form ever-more powerful dynamics that shifted us from the post-WWII settlement of the “Golden Age of Capitalism” to the dynamics that have typified oligarchic capitalism since 1980.

At the level of ideology, or the basic knowledge frame of “how the world works,” the post-war broadly shared belief that a mixed-economy, solidaristic and authority-based economic order that supported high growth and broadbased economic security for a more-or-less patriarchal and white family came under sustained attack from neoliberalism on the right, and the New Left, Civil Rights Movement, and Women's Movement on the left. The core organizing institutions of the Golden Age: national regulation, Treaty of Detroit labor relations, a closely regulated financial system with limited global financial flows and restricted financial investment vehicles, and a social-norms derived, union- and elite-opinion-enforced wage compression (for white male workers) reflected a solidarism and epistemological stance about the possibility of authority-based knowledge necessary for command-and-control that was widely rejected by both right and left. As the Great Inflation fundamentally shook the broad confidence in the post-War economic system and weakened it politically, these two basic trends converged on a deregulation program across industries, but in particular the financial industry. While the left mostly re-oriented its economic or labor-market meso-level translations of this fundamental shift to equality-of-opportunity mechanisms and competition promotion for the benefit of consumers, leaving within-market design to others, the right developed a full menu of detailed implementations of the neoliberal intellectual framework. Unions found themselves in direct conflict with the consumers

22Alcindor Rejects A.B.A.'s 3.2 Million dollar offer and will sign with Bucks. March 30, 1969.

23<http://www.nytimes.com/1976/05/02/archives/what-makes-barbara-walters-worth-a-million.html>.

24Isadore Barmash, The New Employer, NYT Oct. 14 1979. <http://www.nytimes.com/1979/10/14/archives/the-new-employer-a-boom-in-retailing.html>.

movement, and talked past concerns of women and minority constituencies. As these internal dynamics on the left were occurring, the ideological right received a boost from a reorganization of businesses toward political intervention. These dynamics left the political arena open to victories for sustained institutional interventions in the shape of economic relations so as to allow extraction of the rents generated in economic production by oligarchic elites, as well as to reduce taxes that allowed those rents to remain as income for the managerial and financial class. This ideological and political dynamic marks the first feedback effect in the system. As political victories further weakened unions and strengthened the hand of organized business, more victories on tax or deregulation were to follow, further increasing rent-extraction opportunities, the funding for political gains, and the funding and prestige of the economics profession that provided the knowledge framework within which these gains could be justified and extended.

Social norms shifts complemented the ideological and political shifts, away from solidaristic perceptions of self and performance and toward individualistic perceptions. The shift in the idea of the superstar exhibits this shift most clearly, as over the course of the 1970s, what started out as an art-world appropriation of a sports metaphor came to define a new role for corporate leadership, and a new perception about the relative centrality of superstar leadership to corporate performance. The transformation of norms around “the superstar” translated into elite cultural change through the concepts of superstar salaries and winner-take-all markets, on the one hand, and agency theory and its shareholder value theory of corporate governance and management, on the other. Together, these created a ratcheting dynamic: legitimation of high, stock-based compensation for executives, reported compensation as a core metric for status competition by announcing the full bi-directional convertibility of status to money, and normalization of new, high levels of compensation. This ratcheting dynamic is the second feedback effect we encounter in the story. As companies began to see each other’s compensation (through SEC disclosure rules), each board aimed to compensate its directors at the higher end of normal, so that with each new round of compensation decisions, a new, higher level was created for the boards making the decision to match.

The Great Inflation and its effects on knowledge, politics, and deregulation influenced not only the labor market, but the critical vector of top 1% compensation increase, the capital markets and the financialization of the U.S. economy. Stock-based compensation tied the labor market returns of executives to the performance of the stock market, and the stock market responded to a series of basic changes driven by the great inflation, deregulation, and computerized spreadsheets. Inflation and the need to obtain high interest rates to protect consumer-savers from it justified early banking deregulation, and high interest rates introduced to stem inflation drew both higher-risk investing international financial flows and newly-deregulated or created retirement funds and vehicles. These supply shocks in the financial market fed the debt-fueled M&A market, particularly the LBO market, which reset the social norms expectations for what executive compensation looked like. This introduced a feedback effect between capital market changes and the labor market: played out as the earnings management game, the disinvestment from labor and reorientation toward financial profits by non-financial firms, which found their way to the bottom lines of executives making these decisions for both labor markets and capital markets. Labor cost savings became the easiest mechanism to boost short term stock returns, and hence executive compensation. Offshoring was supported by a combination of the shipping container, which dramatically altered the cost and speed of international shipping, the barcode, which made supply chain management on a globalized level possible, as well as permitting a substantial increase in the size of firms now better able to manage internal flows as well as

external supplies,²⁵ and the coaxial transoceanic cable that dramatically increased the capacity and fidelity of international communications flows. The feedback dynamic between labor and capital markets, mediated by stock-based executive compensation, was fundamental, and drove both middle-income wage stagnation and top 1% income explosion. And capital markets, in turn, were transformed by the emergence of cross-border financial flows after the collapse of Bretton Woods, the deregulation of financial markets, and the adoption of the PC and spreadsheet that made new theories of finance developed in the 1960s and early 1970s computable and translatable into the practice in the form of the new exotic instruments that came to rule the financialized economy. Financialization and indexing, in turn, underwrote the emergence of the core set of investment advisors and mutual funds that drove the dramatic increase in horizontal shareholding, increasing effective market concentration, the prevalence of rents or markups, and the scope for market power, under weaker market discipline, to distribute those rents.²⁶

These dynamics, in turn, again fed back into the political system that continued to introduce institutional interventions that supported this dynamic—as the story of option accounting here demonstrates. These played out across diverse settings I do not cover here, with top marginal tax, capital gains tax, international avoidance of corporate tax, and the tax treatment of carried interest in hedge funds being among the most obvious instances of institutions designed to maximize oligarchic extraction. But the story I tell here is not a simple organized business story capturing rents either. A study of the deregulation movement of the 1970s, in particular the airline, trucking, and telecommunications industries, shows that the split within the left, between the consumer and the worker as object of concern, created significant tension within the economically-focused left and clearly weakened it. This political dynamic, in turn, helps to explain the basic acceptance by the political center-left of the core neoliberal institutional prescriptions for market design (leaving post-market redistribution and equal opportunity as the core foci of the politics of economic equality) throughout the 1990s. Only after the Great Recession, and in some sense even only after the Occupy movement, did the long-standing criticism of the left begin to enter the mainstream of politics in the United States, but by that time the disillusionment had also created the space for the rise of the radical right both in the United States and Europe.

I came to this study from many years of thinking about technology and its social impact. I leave it with a political economy that seeks to integrate diverse systems into a single multi-dimensional story. Personal computers certainly were necessary to make leveraged buyouts or collateralized debt obligations possible, and information technology was a precondition for running global supply chains at a level of efficiency necessary to allow large scale offshoring. But there were many countries at the same technological frontier, and their patterns of adoption, labor practices, and economic inequality were substantially different than they were in the U.S. If the multi-dimensional political economy dynamic I describe here is a better explanation of the changes in labor markets and income inequality over the last forty years than skills-biased technical change or winner-take-all markets, then current debates over the future of work, robots and AI, the gig economy, or ubiquitous surveillance technology in the workplace are based on too naïve a conception of the relationship between technology and these other systems of social organization. It is still possible, within the framework I offer here, that these technological trends will overwhelm the other systems that operate to shape the organization of production. But looking back at the past forty five years suggests that even if these technological

25Bartholomew C. Watson, “Barcode Empires: Politics, Digital Technology, and Comparative Retail Firm Strategies,” *Journal of Industry, Competition and Trade* 11, no. 3 (September 2011): 309–24, doi:10.1007/s10842-011-0109-2.

26Einer Elhauge, “Horizontal Shareholding,” *Harvard Law Review* 129 (March 10, 2016): 1267–1317.

trends are very strong, they will nonetheless be shaped and molded by how power is deployed in other social systems that interact with technology. When we imagine responses to technological change, we need not treat technology as a monolithic fact, to be endured as an exogenous force. We must understand it instead as the subject of continuous political contest and social organization. Introduced into unreformed oligarchic capitalism, the new technology will indeed exacerbate the already-extreme inequality we have seen in the past forty years. But if we are able to reorient market society, and re-embed economic production in social relations, there is no inherent reason why the emerging technological capabilities will necessarily result in the continued patterns of broad-based economic insecurity and the reproduction of oligarchy. Indeed, quite the opposite is true.

Political Economy: Power vs. Productivity

How one interprets the past forty years and predicts the next decades depends crucially on where one falls along a spectrum of views regarding two critical questions: how efficient markets are, and how important are ideology or knowledge frameworks, technology, and institutions—law, social norms, and politics. Despite longstanding work to the contrary within the discipline, the mainstream of the economics profession behaves as though it still assumes that as long as states define property and contract rights correctly, and don't regulate too much, markets are more-or-less efficient; people more-or-less know what their interests and preferences are, and have more-or-less reasonable access to information about their own preferences, the range of options open to them for action, and the consequences of their actions. If labor markets now pay line-workers 300 times less than executives, whereas forty years ago the ratio was 1:50, then something about the relative value of executives and line workers changed to make the contributions of the former that much more valuable than those of the latter. The rise of behavioral economics within the profession has required some modification, although the core of the discipline still treats these behavioral deviations as predictable and manageable through debiasing. The longstanding critiques about imperfect information, transactions costs and institutions, and so forth have all, in one form or another, been assimilated as corrections rather than fundamental challenges.

The alternative is that production and distribution operate in a system that has a much higher tolerance for sustained inefficiency, making power, not efficiency, the driving force around the organization of work, effecting both sustained productivity and the distribution of rents. People are satisficers, not maximizers; and are vaguely, not precisely informed;²⁷ their preferences are endogenous and socially-constructed, including through demand management (advertising);²⁸ prices and practices do not converge, but are rather noisy, so that it is possible for quite divergent practices to persist for a very long time. Law and institutions influence bargaining power in markets more importantly than efficiency, and it is that bargaining power that shapes the organization of production and the distribution of its fruits.²⁹ And it is institutions and the political coalitions they reflect that gives us the substantial and sustained difference between the liberal Anglo-American, Continental European Christian Democratic, and Nordic Social Democratic models of welfare capitalism,³⁰ all working at the same technological frontier, and all working within the social relations of capitalism but with large and sustained differences in the patterns of inequality,³¹ including the extent to which their populations experience broadbased economic insecurity or their elites can extract a growing share of national

27Herbert A. Simon, *Administrative Behavior: A Study of Decision-Making Processes in Administrative Organizations*, 4th ed (New York: Free Press, 1997).

28Thorstein Veblen, *The Theory of the Leisure Class*, Reissued, Oxford World's Classics (Oxford: Oxford Univ. Press, 2009).

29Hale, Coercion and Distribution in a Supposedly Noncoercive state.

30Gøsta Esping-Andersen, *The Three Worlds of Welfare Capitalism* (Princeton, N.J.: Princeton University Press, 1990); Peter A. Hall and David W. Soskice, eds., *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford [England] ; New York: Oxford University Press, 2001); Kathleen Ann Thelen, *Varieties of Liberalization and the New Politics of Social Solidarity*, Cambridge Studies in Comparative Politics (Cambridge; New York, N.Y: Cambridge University Press, 2014).

31Thomas Piketty, *Capital in the Twenty-First Century*, trans. Arthur Goldhammer, First Edition edition (Cambridge Massachusetts: Belknap Press, 2014); Alvaredo et al., "The Top 1 Percent in International and Historical Perspective"; Stand and OECD, *An Overview of Growing Income Inequalities in OECD Countries*.

income,³² the extent to which they see intergenerational economic mobility,³³ or the health outcomes of their populations.³⁴ This doesn't mean that markets and prices are entirely inoperative. Big shifts make a real difference. Within an institutional setting, relative supply and demand will make a difference around which a broad cloud of variation will exist, and most of the important variation will be within that cloud. But the difference between a MacDonald's job in Denmark, earning \$20 an hour with stable hours, New Zealand at \$12.35, both unionized with hours assurances, and U.S. fast food workers averaging \$8.69 without assurances regarding hours make all the difference that matters.³⁵ And these difference do not reflect differences of where these countries are on the technological frontier, or the integration into a global economy. Denmark has higher inter-generational mobility than the U.S. and, ironically, is ranked as equally economically "free" by the neoliberal Heritage Foundation, while New Zealand is ranked much higher on that *Index of Economic Freedom*.³⁶ The same is true for the interaction of technology with markets. Horse and buggy transportation dies in the face of the internal combustion engine. Halving the cost of computation every 18 months for half a century drives a shift in use of computation (although even that rate is a function of business strategy and technological choice, not an exogenous technological fact). But within these broad hard boundaries, there is room for substantial and sustained variation in practice, which matters tremendously for both productivity and inequality over sustained periods.

A second dimension of important variation is around institutions. In the neoclassical model, institutions are largely assumed away. In much of the new institutional economics, institutions do matter, but primarily in the short run: market forces are so strong that efficient institutions outcompete inefficient institutions within countries, and societies that adopt suboptimal institutions get outcompeted by those who adopt optimal institutions. This was the core thrust of much of the early work in law and economics around the 1970s and 1980s, and, indeed, provided the normative content of that movement (adopt institutions that increase the size of the pie; leave post-market distribution to politics).³⁷ That is, a society that adopts an efficient rule will outcompete a society that adopts an inefficient rule, and either the former will displace the latter or the latter will learn about the greater efficiency and adopt the more efficient institution. In the long term, market efficiency drives productivity, and productivity drives institutional adoption and change. Nations that do not adopt more-or-less efficient market institutions fail,³⁸ although the persistence of political interest, ideology, and culture may nonetheless lead nations to maintain inefficient and ultimately failing institutions for long

32Alvaredo et al., "The Top 1 Percent in International and Historical Perspective."

33Miles Corak, "Income Inequality, Equality of Opportunity, and Intergenerational Mobility," *Journal of Economic Perspectives* 27, no. 3 (August 2013): 79–102, doi:10.1257/jep.27.3.79; Paolo Brunori, Francisco HG Ferreira, and Vito Peragine, "Inequality of Opportunity, Income Inequality and Economic Mobility: Some International Comparisons," *World Bank Policy Research Working Paper*, no. 6304 (2013), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2197675.

34Anne Case and Angus Deaton, "Rising Morbidity and Mortality in Midlife among White Non-Hispanic Americans in the 21st Century," *Proceedings of the National Academy of Sciences* 112, no. 49 (December 8, 2015): 15078–83, doi:10.1073/pnas.1518393112.

35 Kevin Short, Working at McDonalds' is Starkly Different in These 3 Countries, Huffingont Post 5/15/2014, http://www.huffingtonpost.com/2014/05/15/global-mcdonalds-protests_n_5324938.html; Liz Alderman and Steve Greenhouse, *Living Wages, Rarity for U.S. Fast-food Workers, Served Up in Denmark*, New York Times, Oct 27, 2014, <https://www.nytimes.com/2014/10/28/business/international/living-wages-served-in-denmark-fast-food-restaurants.html?mcubz=1>.

36 Heritage Foundation Index of Economic Freedom, <http://www.heritage.org/index/>.

37Demsetz, Fur Trade; Posner, Economic Analysis of Law

38Daron Acemoglu and James A. Robinson, *Why Nations Fail: The Origins of Power, Prosperity and Poverty*, 1st ed (New York: Crown Publishers, 2012).

periods.³⁹ What this tradition does well is explain the opulence of modern market democracies by comparison to other societies; what it does not do well is explain the persistence of substantially different institutional arrangements, with significantly different social outcomes, along roughly the same productivity frontier. It doesn't, in other words, explain the persistent differences between the broad groups of different capitalist societies, or even the internal differences between the United Kingdom and the United States, on the one hand, and Canada or Australia, on the other hand.

Beginning in the 1980s, an increasing amount of work has documented that there is indeed substantial variation among capitalist societies, and that a noisy-markets, sticky-institutions approach is likely a better description of the way the world works than alternatives that tend to point toward convergence on optimally regulated, free market systems. Early work focused on path dependency, and the fact that different economies, regions, or sectors developed substantially and sustainably different models of production, as in Piore and Sabel's work,⁴⁰ Unger's critique of "False Necessity,"⁴¹ or Esping Anderson's studies of the diversity of social democratic models.⁴² By the early 2000s, a substantial body of work emphasized diversity within market societies, as opposed to convergence on an equilibrium state.⁴³ Thelen's rich work on varieties of liberalization,⁴⁴ working within the literature on varieties of capitalism,⁴⁵ offers perhaps the best account of how the different families of welfare capitalism responded to the shift from manufacturing to services and globalization. Moreover, labor economists have long struggled with the acknowledged fact that labor markets do not converge, that different firms within an industry or sector maintain different wages for seemingly equivalent jobs, and that rents or markups seem to persist.⁴⁶ Most recently, the sustained evidence of both lower productivity growth and growing inequality has led mainstays of the economics profession to wonder whether rents or markups are high enough and sustained enough to explain inequality or weak productivity.⁴⁷ If rents are substantial and sustained,⁴⁸ firms can get away both with paying managers very high wages (contributing to inequality) and with misallocating resources (contributing to weaker productivity). And recent work on horizontal shareholding by investment advisors and mutual funds has further established that, in the US, not only has market concentration increased, but it has done so through mechanisms directly tied to the deregulation of financial markets and the rise of financialization.⁴⁸ The most prominent formal public expression of the recognition of the role of

39Douglass C. North, *Institutions, Institutional Change, and Economic Performance*, The Political Economy of Institutions and Decisions (Cambridge ; New York: Cambridge University Press, 1990).

40Michael J. Piore and Charles F. Sabel, *The Second Industrial Divide: Possibilities for Prosperity*, Nachdr. (New York: Basic Books, 2000).

41Roberto Mangabeira Unger, *False Necessity--Anti-Necessitarian Social Theory in the Service of Radical Democracy: From Politics, a Work in Constructive Social Theory*, Pbk. ed, Politics, v. 1 (London ; New York: Verso, 2004).

42Gøsta Esping-Andersen, *The Three Worlds of Welfare Capitalism* (Princeton, N.J.: Princeton University Press, 1990).

43Bruno Amable, *The Diversity of Modern Capitalism* (Oxford ; New York: Oxford University Press, 2003).

44Thelen, *Varieties of Liberalization and the New Politics of Social Solidarity*.

45Hall and Soskice, *Varieties of Capitalism*.

46Carl Shapiro and Joseph Stiglitz, "Equilibrium Unemployment as a Worker Discipline Device," *American Economic Review* 74, no. 3 (1984): 433-44; Lawrence F. Katz and Lawrence H. Summers, "Industry Rents: Evidence and Implications," *Brookings Papers: Microeconomics*, 1989, http://www.brookings.edu/~media/Projects/BPEA/1989-micro/1989_bpeamicro_katz.PDF.

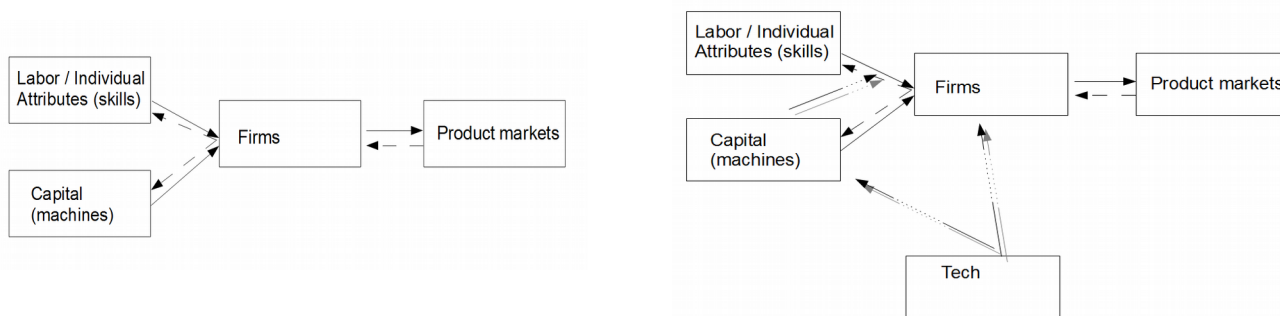
47Robert Solow, "The Future of Work: Why Wages Aren't Keeping Up — Pacific Standard," accessed May 26, 2016, <https://psmag.com/the-future-of-work-why-wages-aren-t-keeping-up-6fcfac468e4#.7oarif403>; Jason Furman and Peter Orszag, "A Firm-Level Perspective on the Role of Rents in the Rise in Inequality," *Presentation at "A Just Society" Centennial Event in Honor of Joseph Stiglitz Columbia University*, 2015, <http://gabriel-zucman.eu/files/teaching/FurmanOrszag15.pdf>.

48Jose Azar, Martine C Schmalz, and Isabel Tecu, "Anti-Competitive Effects of Common Ownership," July 5, 2016, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2427345; Elhauge, "Horizontal Shareholding."

sustained market power and rent extraction in shaping both income inequality and slow productivity growth was the 2016 Economic Report of the President,⁴⁹ tied to a set of policy proposals far more classically progressive than had been the mainstream agenda of the Democratic Party in the United States since the 1980s.

If markets are noisy and institutions are sticky, power becomes a central force in determining how we organize production and distribute its fruits. This can be power along any one of several dimensions: direct economic bargaining power, such as with unions or board participation; political power, as with taxation or minimum wage laws; social-norms power, as tamped down on executive pay in the 1940s and 1950s; or the power to shape ideas about how the world works, which drive so many other decisions, as we saw with rational actor modeling, agency theory, and shareholder value in the 1980s and 1990s. Power, more than relative productivity, determines the magnitude and distribution of rents in an economy when markets are too noisy to discipline behavior of firms and individuals within a given institutional framework, or to force institutions to change because of their suboptimal performance.

Contemporary debates about the future of work, the influence of robots or on-demand platforms like Uber are largely conducted within the neoclassical framework. Whether robots will, or will not, take jobs, is argued in terms of the susceptibility of discrete tasks to automation, and hence predictions of how a more-or-less efficient market will respond to the skills of people who now perform those tasks. Whether on-demand economy models are the future could be understood within the new institutionalist framework of transactions-costs: platforms reduce transactions costs, so that their model simply is more efficient than firm-based production (I've made this argument myself, so this is not about finger-pointing) and trying to legislate the fundamental shift in transactions costs away is like trying to legislate away the effect of the Internet on circuit-switched telephone networks. It may work for a few years, but it cannot legislate away the fundamental technological shift.



As Figures 1a and 1b show, it is very intuitive to describe this model. Workers come to the market with individual attributes, which firms combine with capital, sell the products in markets, and then redistribute the returns to workers and capital based on their comparative value, as judged by labor markets and the markets for capital inputs. Technology impacts the capital or processes available to the firms (the firm's production function) in ways that impact the relative value of labor or the skills that labor brings to the table. Imagine, for example, that workers have two kinds of attributes, x and y , and that firms employ technology that is neutral as among workers with x and workers with y attribute. If you imagine that technology changes exogenously so as to double the productivity of x

⁴⁹Council of Economic Advisors, "Economic Report of the President," February 22, 2016, https://www.whitehouse.gov/sites/default/files/docs/ERP_2016_Book_Complete%20JA.pdf.

attribute (education, height, patience), such that it makes x workers twice as productive as before, but does not change the productivity of y workers at all, then x workers become twice as valuable as y workers. The various theories of skills-biased technical change differ in which “skills” they associate with “ x ”. In the “canonical” model, x is simply more education; in the “tasks framework,” x is capacity for doing non-routine work, whether high-education (designing trading algorithms) or low education (carrying bricks around in a messy construction site). But the basic model is the same, and it crucially depends on labor and product markets efficiently recognizing the productivity difference and translating it into a wage difference.

The “canonical” SBTC theory added an important institutional component—education policy. It took market structures as given, but the attributes of workers as changing continuously with education—more education made more skill. The change, for Goldin and Katz most explicitly, was in the institutional framework surrounding education.⁵⁰ The early-20th century movement to increase high school education allowed skills to outpace technology, leading to wage compression in mid-century. Late 20th century failure to expand college level education allowed technological change to outpace educational upgrading, leading to wage dispersion. Critically, the institutional element in this model is not about the production function—it does not itself determine the relative value of different kinds of labor or the labor/capital mix. It accepts markets as given and focuses on the attributes of workers. This model is critical to understand because it is also the foundation of “equal opportunity” approaches to educational and workplace discrimination. The assumption in equal opportunity egalitarianism is that, absent discrimination, markets would reflect the relevant merit of workers, and that it is in the institutional distribution of opportunities—in education or hiring, most explicitly—or in systematic misidentification of merit—in promotions—that inequality in labor markets inheres. The most obvious, and widely supported policy response provided by this understanding of technology and inequality is to change the attributes of individuals to fit the technological change—increase skills and education. That is the correct and humane response. The other part of the solution is to redistribute, after the market finishes distributing income, by taxing the winners and supporting the losers from the technological change until those whose values has declined have upgraded their skills and no longer need support.

An egalitarian who believes as a factual matter that markets are more-or-less efficient and institutions don't fundamentally shape market behaviors and income, will focus on imposing efficient taxes and redistribution. Imposing a general income tax and a generous transfer payment policy could achieve a relatively egalitarian ultimate outcome, while preserving the efficiency and productivity-enhancing features of “free” markets. The limit of egalitarian policy is the dampening of incentives to operate in markets, and hence on productivity and the welfare available for redistribution. This is the core liberal approach, most famously implemented in Rawls' *Theory of Justice*. An egalitarian who believes that markets are more or less efficient, and that institutions matter significantly only to the opportunities to participate in that efficient market, will focus on equality of opportunity. As Erik Olin Wright put it, “opportunity hoarding” models differ from criticism of inequality that focus on power within the production process itself in their assumption that once the opportunity hoarding practices of the “in” group—gender, race, educational status—are reversed through institutional change—like investment in public education, or prohibition of workplace discrimination—the subjects of former exclusion will participate in the market and be able to obtain rewards commensurate with their

⁵⁰Claudia Goldin and Lawrence F. Katz, *The Race between Education and Technology* (Cambridge, Mass.: Belknap Press, 2010).

capabilities.⁵¹ This offers quite a bit of range, from fairly focused demands to invest in public education, like Goldin and Katz,⁵² to quite expansive theories of giving every baby a citizen's bond that they can then spend in the market, like Ackerman and Alstott.⁵³ If power (the ability of one person or class of people to impose outcomes on others) operates in this framework at all, it operates at the level of exclusion from opportunities, like old boys clubs, and it is that power that needs to be countered by political institutions.

But one might also hold the position that institutions matter a great deal in the organization of production and distribution directly. Labor and employment laws, corporate governance, social norms regarding compensation, unemployment insurance and so forth all directly affect the distribution of power within markets, and hence the organization of production and the distribution of surplus.⁵⁴ If one sees markets as loose constraints on the behavior of firms, then power and institutions become central to how production is organized and how the surplus created from production is divided. An egalitarian who held these views might focus on the bargaining power within an organization or industry, by emphasizing the importance of unions in both organization of work and distribution of rents.⁵⁵ An egalitarian might focus on leveraging public political power to set minimum wages and generalize union-negotiated agreements in leading firms to a region or sector.⁵⁶ Another alternative would be to focus on changing ownership by focusing on creating cooperatives, or worker-owned firms, or worker board representation.⁵⁷ Yet another would be to focus on corporate cultural change, emphasizing the productivity of organizations that adopt trust-based strategies, or adoption of a double or triple bottom line addressing a range of concerns from environmental stewardship to worker welfare.⁵⁸ Some of these strategies claim that firms that are more socially-oriented, trust-based, and even egalitarian (or at least offer better wages) will perform better even assuming an efficient market. Others argue that firms and societies have a decent amount of play in the joints—that there simply is no one narrow path to efficiency and growth. All these diverse approaches emphasize the importance of institutions to determining the distribution of market income in the long run, even keeping constant tax and transfer policy for redistributing market income, on the one hand, or equal opportunity to access markets, on the other hand.

This kind of institutional analysis that goes beyond the simple new institutionalism is harder to describe in crisp graphs, much less in parsimonious equations. The most successful such effort was the

51Erik Olin Wright, "Understanding Class: Towards an Integrated Analytical Approach," *New Left Review* 60, no. November–December (2009): 101–16.

52Goldin and Katz, *The Race between Education and Technology*.

53Bruce A. Ackerman and Anne Alstott, *The Stakeholder Society* (New Haven, Conn: Yale University Press, 1999).

54Mishel, Schmitt, and Shierholz, "Wage Inequality."

55Card, Lemieux, and Riddell, "Unions and Wage Inequality," 2004; Western and Rosenfeld, "Unions, Norms, and the Rise in US Wage Inequality."

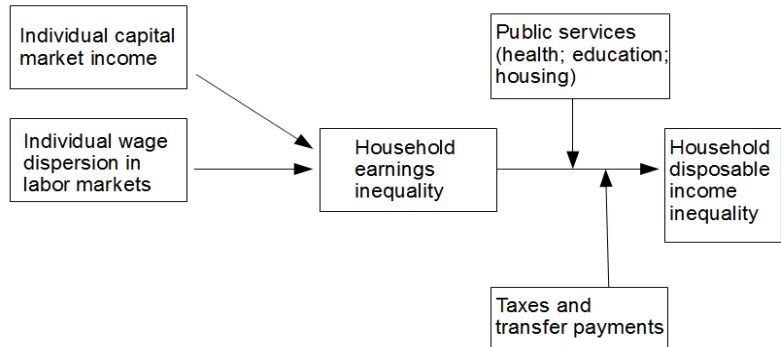
56Hacker and Pierson, *Winner-Take-All Politics*, 2010.

57Richard B. Freeman, "Who Owns the Robots Rules the World," in *JOLE Meetings May, 2014*, <http://www.sole-jole.org/Freeman.pdf>; Joseph R. Blasi, Richard B. Freeman, and Douglas Kruse, *The Citizen's Share: Reducing Inequality in the 21st Century*, Paperback edition (New Haven: Yale University Press, 2014); Trebor Scholz, "Platform Cooperativism," *Challenging the Corporate Sharing Economy*. New York, NY: Rosa Luxemburg Foundation, 2016, http://www.rosalux-nyc.org/wp-content/files_mf/scholz_platformcooperativism21.pdf.

58Charles Heckscher and Paul Adler, *The Corporation as a Collaborative Community: Organization in the Knowledge-Based Economy* (Oxford: Oxford University Press, 2005); Beer, Eisenstat, and Foote, *High Commitment, High Performance*; Zeynep Ton, "Why 'Good Jobs' Are Good for Retailers," *Harvard Business Review*, accessed October 22, 2015, <https://hbr.org/2012/01/why-good-jobs-are-good-for-retailers>.

Institutional Analysis and Development (IAD) framework, developed by Elinor Ostrom and collaborators, although it was developed from, and primarily adapted to, analyzing commons governance regimes for discrete common pool resource systems.⁵⁹ A newer attempt to anchor analysis of organizational change in a richer context of institutional analysis was Padgett and Powell's adaptation of the complex chemical emergence process of autocatalysis.⁶⁰ Like most presentations of complex processes, both chemical and ecological, these approaches offered more complicated graphical representations of the processes involved, and this has come at the expense of tractability. What I offer here is something of a synthesis of these approaches, applied to the simple story of technology and individual income.

At baseline consider how one might simply describe the components that go into household income inequality. Figure 3 breaks out the components into individual wage and capital income dispersion, combining into household market earnings inequality, which may then be more or less moderated by some combination of taxes and cash transfer payments and public services that allow households to divert less of their household income to core necessities like health, education, or housing.⁶¹ This framework can trivially be applied to efficient markets, by assuming that the two core inputs, labor income dispersion and capital income dispersion at the individual level reflect efficient market valuations of the individual's labor or their capital investments.



⁵⁹Elinor Ostrom, "Background on the Institutional Analysis and Development Framework," *Policy Studies Journal* 39, no. 1 (2011): 7–27.

⁶⁰John Frederick Padgett and Walter W. Powell, eds., *The Emergence of Organizations and Markets* (Princeton: Princeton University Press, 2012).

⁶¹These images are adapted from Box 1 of the OECD report on inequality, albeit with substantial variation. OECD *Divided We Stand, An Overview of Growing Income Inequalities in OECD Countries*. (OECD. Retrieved from <http://www.oecd.org/els/soc/49499779.pdf>, 2011), http://www.sabanciuniv.edu/HaberlerDuyurular/Documents/S_/2012/47987-1355919648-DwS_overview.pdf.

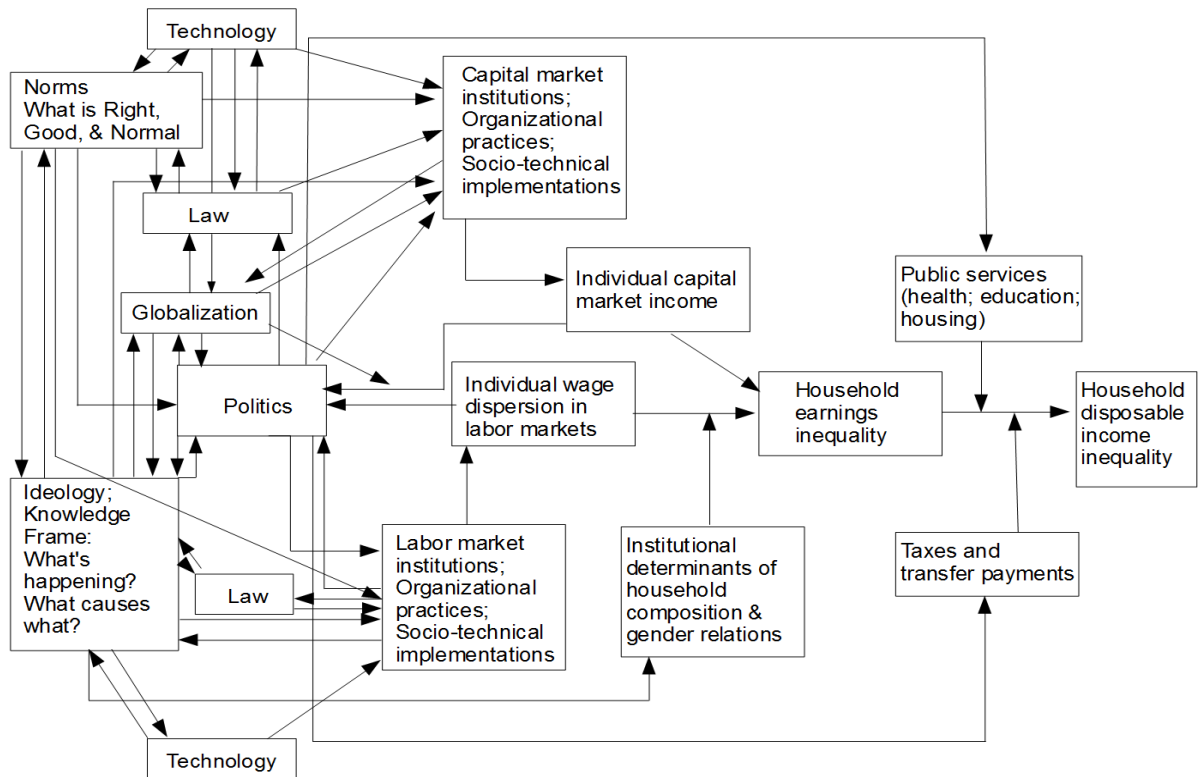


Figure 4, by contrast, seeks to introduce several significant explanatory dimensions, as well as the interactions among them. By “institutions” here I mean both formal institutions, law and explicit social norms whose violation would elicit well-understood social sanctions, and informal institutions that are understood tacitly and mostly internalized, rather than externally enforced. To these I add explicitly politics, organizational practices, socio-technical implementations (by which I mean to underscore that “technology” as implemented is not exogenous to the social process that incorporates technology into social relations) and globalization as a discrete dynamic, although it could itself be simply described as a particular structure within labor, capital, and product markets. I also add “ideology or knowledge frame,” not in the sense of left/right ideology, but in the sense of our basic understanding of how the world works, what causes what, and how various instrumental interventions are likely to influence actual outcomes and practices in the world. And I use norms to describe social understandings, both elite and popular, of what is right, what is good, and what is normal, in the sense of what class of behaviors conform to the normal in society at a given time. Technology plays a role in these dynamics, in interaction with these other systems for organizing human interaction, rather than as an exogenous force. (Technology and law show up twice for simply clarity of drawing the causal connections, not because there are different types of technology or law.) These components, in turn, influence labor and capital market income dispersion, household composition and earnings potential surrounding particularly gender norms, as well as the magnitude and focus of transfer payments and public goods provisioned. They also feed back into each other, such that initial small changes (say, banking deregulation and early union political losses in the 1970s) can feed back into the various elements of the system, and amplify the same effects in the next round (say, securitization and global capital flows, as well as the union busting politics of Reagan and Thatcher administrations, in the 1980s). It is these feedbacks that are responsible for the extent to which societies can deviate from an earlier equilibrium, and find themselves in a dramatically new equilibrium, as the United States and the

UK found themselves by the late 1990s. It is through these dynamics, I suggest, that the US and the UK became over this period such outliers in terms both of the share of market income going to the top 1% being particularly high, and the reduction in top marginal tax rate.⁶² While this description is more complicated, and because of the posited feedbacks, likely complex and difficult to diagnose deterministically, it has the benefit of providing clear targets for analysis—both historical and policy planning. The feedbacks explain how change can accelerate and transition so dramatically over a relatively short period, as we saw in the rise of the 1%. The interdependence between the systems explains why divergent patterns in different polities and societies can persist in the teeth of similar technological and market pressures. Once a transition occurs, the changes in the several systems that interact to reinforce each other as ideology, institutions (law, norms, organizational practices, politics), and technology stabilize on a common model. Only relatively large shocks can nudge such a new equilibrium into a new disequilibrium, during which the terms of the next equilibrium are fought out.

The market production relationship is embedded in basic background knowledge of how the world works. As we will see in the detailed analysis of the rise of the top 1%, ideas changed dramatically in the 1970s. Macro-level ideas like the rational actor theory and the emergence of self-actualization were translated into meso-level operative ideas, like shareholder value and agency theory, or the bi-directional convertibility of superstar status and salary. Social norms shifted, and benchmarks for executive compensation shifted, sometimes in ways that responded to a change of ideas and norms, and sometimes in direct response to financialization and the emergence of the LBO market. Technology played a role—global supply chains necessary to implement labor disinvestment in response to the short termism that financialization and executive compensation introduced, and the global capital flows necessary to fuel that financialization, would have been unmanageable without information and communications technologies that developed in the 1970s and 1980s, while the securitization necessary to that same process would have been impossible without the personal computer and spreadsheet.

Given the substantial variations in how these trends played out in different countries at the same technological frontier, however, it is difficult to argue that the technological changes themselves determined the outcome in markets. This is what is implied by the term “socio-technical implementations.” The introduction of bar codes led to dramatic changes in supply chain management and increased the size of chains, but nonetheless resulted in fundamentally different market structures between producers, small businesses, consumers, and the new growing chains in different countries that responded to different politics and institutions.⁶³ Robotic density in Germany and Japan in manufacturing in general and automotive in particular has long been higher than in the United States,⁶⁴ but employment in these sectors did not decline as it did in the U.S., operating as they did under fundamentally different labor institutions and organizational practices. But these systems also fed back into each other and altered the perceived value and bargaining power of all parties within the production relationship. As I will describe here, for example, changes in ideas and political focus on

62Thomas Piketty, Emmanuel Saez, and Stefanie Stantcheva, “Optimal Taxation of Top Labor Incomes: A Tale of Three Elasticities” (National Bureau of Economic Research, 2011), <http://www.nber.org/papers/w17616>; Facundo Alvaredo et al., “The Top 1 Percent in International and Historical Perspective,” *Journal of Economic Perspectives* 27, no. 3 (August 2013): 3–20, doi:10.1257/jep.27.3.3.

63Bartholomew C. Watson, “Barcode Empires: Politics, Digital Technology, and Comparative Retail Firm Strategies,” *Journal of Industry, Competition and Trade* 11, no. 3 (September 2011): 309–24, doi:10.1007/s10842-011-0109-2.

64International Federation of Robotics, *World Robotics 2005* (United Nations Publications, 2005); and annual updates since reviewed by author.

the left interacted with neoliberal ideas and politics on the right surrounding deregulation of trucking, airlines, and most importantly banking, to underwrite the political losses for labor that drove the decline of unions; these, in turn, removed one of the core sources of constraint on the social benchmarking and ratcheting effect of executive compensation, while also systematically weakening the political power of Democrats in the economic arena, leading to further losses of power and institutionally-supported bargaining power. That bargaining power, in turn, is critical once we recognize that the value and contribution of entities in an economic production relationship is noisy, and there is substantial uncertainty as to the contribution each makes, leaving substantial rents to be allocated.

By “organizational practices” I mean to adopt from organizational sociology and management science the rejection of the economists' view of firms as thin, uniform entities, essentially production functions. “Organizational practices” aims to focus the analysis on the much more real-world observation that organizations are diverse and persist in their divergent practices for decades: some pay more than others for the same jobs; some are more trust based and non-hierarchical; others more rigidly hierarchical and centralized. These differences matter to the well-being of everyone associated with the firm, as well as its productivity, although the impact on productivity is insufficient to cause convergence on best practices, even in the long run. Similarly, individuals should be seen not only as more-or-less skilled task performers, but also people who have diverse motivational profiles and states, bring social relations to their work and understanding, and have significant insight into their practices born of the fact that information in the system is so fuzzy and error prone, and that imperfection is so pervasive and hard to identify. This is the core insight of substantial work in management science on high commitment high performance organizations, collaborative practices, lean production and so forth. Their “value” to the firm is endogenously determined by the organization's practices—their motivation, insight, skills, social capital etc. contribution is co-determined with organizational practice.

Abstracting away from the question of household income inequality, we might take a simple Schumpeterian competition framework—where firms invest in developing technology in order to create a market that they then monopolize so as to extract rents to cover their investment in developing the new technology—and extend it along several dimensions. First, the actors here are not only firms, but networks of social actors clustered into coherent sets of coordinated action—sometimes intentionally coordinated and sometimes emergent. Second, they act on rent-creation and extraction opportunities not only by investing in technology, but also by investing in ideology or knowledge, and on institutions, or social relations. Third, their actions can affect the magnitude of the rents available by affecting the scale and scope of the market affected (e.g. by focusing on institutional changes that liberalize global financial flows to increase the size of the financialization pie), the defensibility of rents (e.g. by using non-standard interfaces in tippy markets (like Apple), or leveraging first mover advantages in a platform to capture markets that depend on access to that platform (e.g. the Microsoft case); and the bargaining power over distribution of the rents so obtained within the organization capturing the rents (e.g., weakening unions, or developing a shareholder-value based rationale for extracting a higher portion of a firm's revenue). Organizations or actors may tradeoff one or another of these dimensions for the others—as Apple traded magnitude of the market for defensibility and distribution with its insistence on non-standard interfaces, both with the Mac and later the iPhone; or as executives driven by short-term rent extraction within firms traded off longer term defensibility of their firm's position secured through investment in productivity—both labor and capital improvement—in exchange for shorter-term distribution power by disinvesting in labor and shifting to casualized labor.

GM's failure to adopt TPM in the early 1990s⁶⁵ or Verizon's decision to stop investing in fiber to the home networks in the latter 2000s are stark examples.

While the model may be abstract in the high level form I outline here, a case study of the dynamics that allowed the top 1% to capture such a high share of labor income in the U.S. will help put meat on these bare bones.

⁶⁵Rana Foroohar, *Makers and Takers: The Rise of Finance and the Fall of American Business*, First edition (New York: Crown Business, 2016).

The 1% and the limits of the winner-take-all market hypothesis

Between 1993 and 2014, the top 1% of income earners captured over half of all real income growth in the U.S. economy, while the other 99 percent were left to divide the remaining 45%.⁶⁶ Several studies of the makeup of the top 1% have focused variously on “superstars”—celebrity athletes and entertainers; hedge fund managers, investment bankers, and others in the financial industry, and executives and managers. The most conservative estimate places a lower bound on the share of the top 1% that is made up of these occupations, claiming that they cover only 9% of the top 0.5%, and are made up of financial industry employees and lawyers more than executives.⁶⁷ The study offers no plausible explanation for who makes up the remaining 90% of the top 0.5%. Another early paper suggested that when focused only on labor income, not income from capital gains, the share of executives was likely closer to 50%.⁶⁸ The most recent and comprehensive study, and the only one relying on direct analysis of tax returns, suggests that the latter estimate was closer to the truth of the matter.

The most comprehensive study of individual tax information suggests that management (including executives, managers, and supervisors) in non-finance firms, and employees in finance generally (managerial and non-managerial), accounted for 44% in 1979 and 45% of the top 1% of earners in 2005, and 59% in 1979 and 60% of the top 0.1% in 2005.⁶⁹ In terms of changes in the share of total national income going to the top 1% and 0.1%, the influence of these two groups was even larger. Between 1979 and 2005, these two categories of taxpayers accounted for 58% of the increase in the share of national income going to the top 1%, and for 70% of the increase in share of income going to the top 0.1%.⁷⁰ It’s important to emphasize that “managers” here includes a much broader class than those directly affected by executive pay dynamics, and includes managers well down the line. To the extent that their salaries rose with executive salaries, they would have had to have risen by either a market dynamic for a different talent pool, or by a social-norms and benchmarking dynamic that reflected the dynamics higher up the status hierarchy. By contrast, media and sports stars remained stable at 1.6% of the top 1%, and rose from 2.2% to 3% of the top 0.1%; while entrepreneurs declined from 2.7% to 2.3%, and from 3.9% to 3.0% of the top 1% and top 0.1%, respectively. Lawyers rose from 7% to 8.4% of the top 1%, and remained 7.3% of the top 0.1%. The fact that employees in finance and managers, rather than entertainers, software engineers, or entrepreneurs, account for the majority of the top 1% effect questions the winner-take-all markets hypothesis.

66Emmanuel Saez, “Striking It Richer: The Evolution of Top Incomes in the United States (Updated with 2012 Preliminary Estimates),” *Berkeley: University of California, Department of Economics*. <http://Elsa.Berkeley.Edu/~Saez/Saez-USTopincomes-2012.Pdf> et *The World Top Incomes Database*. <http://Topincomes.Gmond.Parisschoolofeconomics.Eu>, 2013, <http://www.nuevatribuna.es/media/nuevatribuna/files/2013/12/20/saez-ustopincomes-2012.pdf>.

67Steven N. Kaplan and Joshua Rauh, “Wall Street and Main Street: What Contributes to the Rise in the Highest Incomes?,” *Review of Financial Studies* 23, no. 3 (March 2010): 1004–50, doi:10.1093/rfs/hhp006. The study includes relatively sparse data from public sources, focuses on the top-five executives in public firms, capturing adjusted gross income, not labor income, and includes a substantial degree of estimation,

68Gordon and Dew-Becker, “Controversies about the Rise of American Inequality.”

69Jon Bakija et al., “Jobs and Income Growth of Top Earners and the Causes of Changing Income Inequality: Evidence from US Tax Return Data,” *Unpublished Manuscript, Williams College*, 2012, <http://piketty.pse.ens.fr/files/Bakijaetal2010.pdf>.

70Jon Bakija et al., “Jobs and Income Growth of Top Earners and the Causes of Changing Income Inequality: Evidence from US Tax Return Data,” *Unpublished Manuscript, Williams College*, 2012, fig. Tables 6a and 7, <http://piketty.pse.ens.fr/files/Bakijaetal2010.pdf>.

The basic technology and efficiency story explaining this shift was that we had entered into a winner-take-all market system.⁷¹ For sports and entertainment superstars, the story was simplest. New communications technologies had made global media markets bigger. The marginal difference between the top performer and the second may be small in substance, but the ability of anyone in the world to have the best, rather than second best, introduced super-high returns to those few who could attract the global market. The analogy for superstar managers followed a similar logic. Deregulation opened up markets so that small differences in efficiency could make one firm win and another lose. Information technology and networked-based business models allowed firms to serve larger audiences, much in the way that the introduction of recorded music allowed a handful of musicians to “perform” for the whole world. As globalized markets allowed firms to serve larger markets, they increased the value of managers who could leverage far-flung operations. The market value of the very best managers, or the lawyers or financiers who worked with them, increased dramatically. Coupled with a cultural change in executive hiring, where firms in the United States in particular began to recruit from a market of “free agents” in management rather than more traditional models of internal promotions, a new market in executive talent emerged, one that actually allowed markets to put a price on the differences between the best, second best, and third best performers. Under these conditions, no reasonable board would go for second best. If the difference the CEO makes is as little as 1% in performance, for a 10 billion dollar company those extra 100 million dollars dwarf a shift from paying that executive 1 or 2 million dollars to paying him 10 or 15 million dollars. In this story efficiency, globalization, and technology, not politics, culture, or power, drove high-end compensation.

Broadcast television personalities pay offers a quick reality check of this superstar model. Broadcast television is one area where network technology shrank, rather than increased audiences. It was a bigger business in 1979 than it is today, and by the logic of superstar salaries or winner take all markets, TV stars who now reach fewer homes should be making less, not more, than their predecessors. Nonetheless, when Barbara Walters became the first television news anchor to make a million dollars (we will return to her story in detail), ABC was viewed by between 6 and 7 million households, and hiring Walters helped ABC catch up to NBC’s news show, which was the second most viewed show. By 1979 each of these networks was watched by over 9 million households. Walters’s \$1 million dollars in 1976 was the equivalent of 3.5 million dollars in 2006, the year Katie Couric was hired by CBS, whose audience by then had declined to less than 6 million households. But Couric’s 15 million dollar compensation dwarfed Walters’s. In 1980, as Walter Cronkite was preparing to retire from the most popular evening news show in America with over 10 million households watching him, Cronkite made the equivalent of 2.2 million in 2006 dollars, and Dan Rather made a continuously-growing salary, from 2.5 million to 6.4 million over the years between 1987 and 2006 when he left the program (all in 2006 terms), all the while earning rising salaries in the teeth of shrinking audiences for all three broadcast network news programs. Something other than technological expansion of relevant markets was operating on these, some of the most visible superstars.

The second leg of the winner-take-all-markets hypothesis is that the very best are in fact better than the second-best, and their marginal contribution is worth every penny they are paid. While the broader dynamics of managerial pay below the executive level have not been studied in detail, executive pay, particularly in public companies, and financialization have been the subject of extensive analysis. Reviewing this literature makes clear that these trends were, at best, uncorrelated to

⁷¹ Sherwin Rosen, “The Economics of Superstars,” *American Economic Review* 71, no. 5 (December 1981): 845–58; Robert H. Frank and Philip J. Cook, *The Winner-Take-All Society: Why the Few at the Top Get So Much More Than the Rest of Us*, Reprint edition (New York, NY: Penguin Books, 1996).

productivity, and more likely have been affirmatively harmful to productivity on an economy-wide scale. Productivity gains over the forty years of oligarchic capitalism have been lower than in the preceding seven decades.⁷² Michael Jensen and Kevin Murphy, who had been the high priests of stock-based compensation and shareholder value in the 1980s,⁷³ by 2012 were writing that corporate officers were playing earnings games rather than improving performance, causing “huge” damage to “investors, customers, employees, communities, and the functioning of capital markets.”⁷⁴ The focus on short term stock value drove deeper problems than the stock manipulations that Jensen and Murphy decry. Gerald Davis's *Managed by Markets* offers the most comprehensive documentation of the broad, productivity-depressing shifts that financialization caused.⁷⁵ Most critically, investment in a stable, long-term, well-trained labor force and R&D suffered because they reflected long-term gains, but short-term costs. By contrast, layoffs and casualization of labor, stock buybacks, and investment in financial portfolio assets contributed little to, or undermined, the long-term productivity of a firm, but yielded short term cost-savings and profits, which, in turn, boosted stock value and with it the value of executive compensation for executives who increasingly were seen as sojourners, free agents in a market for executive talent where today's job was an opening for tomorrow's bid.⁷⁶ Looking more specifically at finance, several recent studies have identified the rise of the financial sector as a contributing cause to the decline in productivity. Finance seems to divert resources from the real economy and innovation to unproductive financial activities that raised short term profits but did not contribute to rising productivity or real growth.⁷⁷

In sum, under oligarchic capitalism between half and two-thirds of the increase in share of income going to the top 1% and 0.1% was caused by rising managerial pay and financial industry compensation. The best evidence we have suggests that both trends in top incomes harmed productivity, rather than improving it, both at the macro, economy-wide scale and at the individual publicly traded firm level.

Executive Pay as microcosm and driver of the 1%

What happened to CEO pay over the course of the 1980s through the 2000s has been the subject of substantial academic work in corporate governance and finance economics. There are two major

72Robert J. Gordon, “The Demise of US Economic Growth: Restatement, Rebuttal, and Reflections” (National Bureau of Economic Research, 2014), <http://www.nber.org/papers/w19895>.

73Jensen and Murphy, It's Not How Much You Pay, but How, Harv. Bus. Rev. May-June 1990 issue. <https://hbr.org/1990/05/ceo-incentives-its-not-how-much-you-pay-but-how>

74Michael Jensen and Kevin Murphy, The Earnings Management Game: It's time to stop it. SSRN 2012. https://www.researchgate.net/publication/256010530_The_Earnings_Management_Game_It's_Time_To_Stop_It

75Gerald F. Davis, *Managed by the Markets: How Finance Reshaped America* (Oxford ; New York: Oxford University Press, 2009).

76Rana Foroohar, *Makers and Takers: The Rise of Finance and the Fall of American Business*, First edition (New York: Crown Business, 2016). Rana Foroohar's story about McNamara, the Whiz Kids, and the shift in American business culture towards bean counters (remote, non-specialist managers driven by numbers; short term numbers through any means, with financial, eg acquisition and stock buy backs, being a more certain and controllable solution than deep changes in manufacturing (e.g. adoption of lean production by GM) or longer term investment in innovation and maintaining the kind of work environment necessary for innovation (Foroohar notes Xerox and HP)

77Jean-Louis Arcand, Enrico Berkes, and Ugo Panizza, “Too Much Finance?,” 2012, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2127541; Stephen G. Cecchetti and Enisse Kharroubi, “Why Does Financial Sector Growth Crowd out Real Economic Growth?,” in *Finance and the Wealth of Nations Workshop, Federal Reserve Bank of San Francisco & The Institute of New Economic Thinking*, 2013, <https://cdn.evbus.com/eventlogos/67785745/cecchetti.pdf>.

camps in the literature.⁷⁸ The first, consistent with the naïve efficiency story more generally, was the optimal contracting and agency theory camp. It argued that CEO compensation reflects an increasingly efficient labor market for managers as well as better, more active shareholder oversight, which have tied executive compensation to increasing shareholder value, and drive firms to reduce inefficiency and waste. The approach is rooted in the work of Michael Jensen, most prominently an early paper with William Meckling⁷⁹ and a later paper with Kevin Murphy.⁸⁰ The evidence of how executive compensation has in fact functioned over the past three decades appears to have led both Jensen⁸¹ and Murphy to despair of the efficiency story, and adopt, particularly in Murphy's case, a political capture story.⁸² The primary alternative camp in the literature on executive compensation has been the managerial power camp, arguing that actual executive compensation practices do not reflect better performance, but rather luck,⁸³ or more damning, that clever executives manipulating compliant boards too confused and weak to offer much resistance as executives enriched themselves at the expense of shareholders, or what Lucien Bebchuk and Jesse Fried called the managerial power theory.⁸⁴ Bebchuk and Fried in particular detailed an extensive range of practices and dynamics within boardrooms that allowed managers to extract rents at the expense of shareholders. But their theory did not seek to explain the transition in the 1980s, nor was it's focus beyond top executives in public firms. For that, we need a dose of history.

Murphy's political history locates the beginning of the era of income compression in top salaries in 1930, when lawsuits involving Bethlehem Steel and American Tobacco revealed that the CEOs of the companies made \$1.6 million and \$1.2 million, or the equivalent of \$23 and \$17 million respectively in 2016 dollars in the midst of the Depression sparked public outrage.⁸⁵ The public outrage led to a series of both disclosure requirements and actual caps on some regulated firms, as bailout loans to railroad companies were tied first to disclosure of executive pay, and then to demand that it be cut by 60%. In 1933, the Senate authorized the administration to “impose an informal (but

78Carola Frydman and Dirk Jenter, “CEO Compensation” (National Bureau of Economic Research, 2010), <http://www.nber.org/papers/w16585>; Kevin J. Murphy, “Executive Compensation,” in *Handbook of Labor Economics*, vol. 3 (Elsevier, 1999), http://ac.els-cdn.com.ezp-prod1.hul.harvard.edu/S1573446399300249/1-s2.0-S1573446399300249-main.pdf?_tid=e4aacffe-49d4-11e6-8695-00000aacb361&acdnat=1468509120_31131ac141f0ef6bf9235bb1f445fe78; *ibid.*; Kevin J. Murphy, “Executive Compensation: Where Are We, and How We Got Here,” in *Handbook of the Economics of Finance*, n.d.

79Michael C. Jensen and William H. Meckling, “A Theory of the Firm: Governance,” *Journal of Financial Economics* 3, no. 4 (1976): 3-5–360.

80Michael C. Jensen and Kevin J. Murphy, “Performance Pay and Top Management Incentives,” *Journal of Political Economy* 98, no. 2 (April 1990): 225–64.

81Michael C. Jensen and Kevin J. Murphy, “The Earnings Management Game: It’s Time To Stop It,” *SSRN Electronic Journal*, 2012, doi:10.2139/ssrn.1894304.

82Murphy, “Executive Compensation: Where Are We, and How We Got Here.”

83Olivier Jean Blanchard, Florencio Lopez-de-Silanes, and Andrei Shleifer, “What Do Firms Do with Cash Windfalls?,” *Journal of Financial Economics* 36, no. 3 (December 1994): 337–60, doi:10.1016/0304-405X(94)90009-4.; M. Bertrand and S. Mullainathan, “Are CEOs Rewarded for Luck? The Ones Without Principals Are,” *The Quarterly Journal of Economics* 116, no. 3 (August 1, 2001): 901–32, doi:10.1162/00335530152466269.

84Lucian Bebchuk and Jesse Fried, *Pay without Performance: The Unfulfilled Promise of Executive Compensation*, 1. Harvard Univ. Press paperback ed (Cambridge, Mass.: Harvard Univ. Press, 2006); Lucian Arye Bebchuk and Jesse M. Fried, “Executive Compensation as an Agency Problem” (National Bureau of Economic Research, 2003), <http://www.nber.org/papers/w9813>.

85Murphy, “Executive Compensation: Where Are We, and How We Got Here.” citing Wells, Harwell, 2010, “No Man can be Worth \$1,000,000 a Year”: The Fight Over Executive Compensation in 1930s America, *U. Richmond Law Review* 44.

uniformly complied with) cap of \$60,000 per year for all railroad CEOs.”⁸⁶ The informality of the requirement (capping at a little over the equivalent of roughly a million dollars in 2016), and the uniform compliance, both suggest that the legislation was intended as a signal of socially-appropriate behavior; and it worked. On the background of this broadly understood social framework, efforts by the Federal Trade Commission and the Securities and Exchange Commission focused on creating new avenues for disclosure that opened boards to both public pressure and union pressure.

Despite the disclosures, it was only during and after World War II that executive pay actually declined. During World War II wage controls on executive pay were put in place as part of broader emergency price stabilization measures, and in the years following some combination of stronger unions and an apparent change in norms regarding what an appropriate ratio of worker to manager compensation set in to introduce the largest decline in executive pay in decades. In the most detailed study, Frydman and Molloy found that the median executive in their sample of 246 firms earned 24 times as much as the average workers in 1940, and this ratio declined to 17 times by 1949.⁸⁷ Analyzing these data Frydman and Molloy find that the most important factors in effecting this change were the levels of unionization in the industry and the change in social norms. As Western and Rosenfeld showed, these two are not entirely independent, as unions are directly involved in setting, as well as enforcing, wage norms, and they do so not only for members and peers of members, but for management as well.⁸⁸

The pattern that emerges from the events at the beginning of the great compression is that a background sense of what counts as an acceptable salary and wage ratio could be translated into political pressure that formalized and made public the social disapproval, which in turn could be applied by various players in their various power arenas. Unions, most clearly, could use the background norms to contain executive pay and tie workers' wages to executives, both creating and reinforcing the norms themselves, enforcing the standards in negotiations, and providing a voice in the political public battles where these were necessary to reset the norms.

It's important to recognize that this story is *not* a social norms story *per se*, but an integrated systems story. Without the legal and political victories of labor in the 1930s and 1940s, there would have been no similar organized and institutionally-embedded body that could enforce the social norms. A perfect example is an excerpt from a 1951 handbook on executive pay cited in recent work by legal scholars Bank, Cheffins and Wells, which emphasizes that “The board of directors today, before approving [executive pay], may well consider the effect upon the company's next collective bargaining negotiation.”⁸⁹ In turn, as the history of the 1990s suggests, once unions largely disappeared from the private sector and norms changed, public law alone could not carry the weight. Even an express congressional limit on executive compensation, the enactment of Internal Revenue Code section 162(m), and broad, bi-partisan public excoriation of the levels of executive compensation simply shifted the forms of compensation to new and camouflaged forms, but did nothing to slow its growth. Social norms have to be embedded in other systems of power to govern behavior, but they exert a sufficiently powerful pull that without a change in social norms, leaving only formal systems to enforce

⁸⁶Ibid., 45.

⁸⁷Carola Frydman and Raven Molloy, “Pay Cuts for the Boss: Executive Compensation in the 1940s,” *The Journal of Economic History* 72, no. 01 (2012): 225–251.

⁸⁸Western and Rosenfeld, “Unions, Norms, and the Rise in US Wage Inequality.”

⁸⁹Bank, Cheffins and Wells, *Executive Pay: What Worked?* Forthcoming Journal of Corporation Law citing THOMAS H. SANDERS, EFFECTS OF TAXATION ON EXECUTIVES 100-1 (1951).

behavioral demands is difficult to enforce and susceptible to intentional hacking and range of unintended failures.

There was more, of course, to solidarity norms than bargaining power. After the Depression and World War II the United States and Europe faced a collapsed civilization and needed to find a way back. At the macro level, the reconstruction involved a more-or-less universal (among advanced economies) embrace of Keynesian economics—the social-scientific understanding of the central role of government in stabilizing the economy, assuring full employment, and managing global trade so that all boats rise with the tide—and of social democracy in some form. These reflected a broad public *zeitgeist* of shared fate translated into national responsibility to assure a more-or-less decent standard of living for all, or a “freedom from want” as Roosevelt put it. The specifics differed significantly among different countries, with the United States having its own distinct model, while the European market-based democracies pursuing several distinct models of social-democracy.⁹⁰ But the core was shared, reflecting a departure from prewar politics by *lassaiz faire* conservatives and socialists alike. The mainstream conservative parties across the industrialized West accepted the mixed economy, and the mainstream left-of-center parties accepted the necessity of private ownership of most economic production outside of core public services. Whether it was the Christian Democratic social market economy in Germany or the national identity solidarism of De Gaul, the more social democratic Nordic model, or the more liberal American and Anglophone model, the core settlement of an economy re-embedded in shared social fate was generalized across these diverse systems. This broad macro-level shift, in turn, manifested itself in diverse institutional and organizational settings at the meso- and macro- levels.

The thirty years of flat and not-too-high executive compensation was one such meso-level effect. Krugman's quotation of John Kenneth Galbraith's description of what elite business norms were in 1967 is indicative:⁹¹

“Management does not go out ruthlessly to reward itself -- a sound management is expected to exercise restraint....”; “With the power of decision goes opportunity for making money. . . . Were everyone to seek to do so . . . the corporation would be a chaos of competitive avarice. But these are not the sort of thing that a good company man does; a remarkably effective code bans such behavior. Group decision-making insures, moreover, that almost everyone's actions and even thoughts are known to others. This acts to enforce the code and, more than incidentally, a high standard of personal honesty as well.”

Maybe this was an ideal; but it was the kind of thing that one of the major economists of the era could write, with a straight face, about what others in the elite of business and economics saw as the way things stood. It suggests how external regulation – whether by law or contract, as with the regulators and unions—or by gossip and shaming, as with the various outraged news stories naming extravagant executive packages, can become internalized. A self-respecting individual, who is concerned over the good opinion of peers, behaves and thinks thus and so. Once this becomes the norm, demanding extravagant pay was not fundamentally different from buying showy bling on the background of an elite culture that uses taste and fashion to exclude the *nouveau riche* from the respect due wealth. The

⁹⁰Esping-Andersen, *The Three Worlds of Welfare Capitalism*.

⁹¹Paul Krugman, “For Richer,” *The New York Times*, October 20, 2002, sec. Magazine, <http://www.nytimes.com/2002/10/20/magazine/for-richer.html>.

normative force of the culture Galbraith describes is underscored by its harshest critic, Milton Friedman, who excoriated “[t]he businessmen” who claim that “business has a ‘social conscience’ and takes seriously its responsibilities for providing employment, eliminating discrimination, [or] avoiding pollution” as “preaching pure and unadulterated socialism.”⁹²

What happened in the 1980s, then, to change these norms? In addition to Western and Rosenfeld's argument about the declining role of unions in enforcing norms, there are two major claims in the economics and business literature about how norms regarding executive pay shifted. The first story is suggested by Holmstrom and Kaplan, who tied this change in norms to the LBO market in the 1980s.⁹³ They argued that early activist investors shifted to stock-based compensation in part in order to incentivize executives to focus on shareholder value, and in part because they were relatively poorer in cash than in stock options. It was this shift in the LBO market, they argue, that led the way in shifting executive compensation toward a large stock and option based component and set new heights, setting new norms for both how, and how much, top management should be paid.⁹⁴ Holmstrom further argued that the critical dynamic of benchmarking—that is, fitting an executive's pay to what is considered normal as a matter of social norms for a person in their position—explained executive compensation more generally, in privately-held firms as well as publicly traded firms. His claim was that a good board tries to avoid an oppositional “arms length” relationship, but instead settles on a reasonable compensation package, where reasonable is based on benchmarking.⁹⁵ An alternative thesis, still focused on the shift in the 1980s, was Rakesh Khurana's argument, based on interviews with 850 firms, that boards and the managerial profession saw a shift in the conception of the CEO.⁹⁶ In the period before 1980 (consistent with the quote from Galbraith above), boards were focused on finding a competent manager who knows the firm's culture, and most promotions were therefore internal. In the 1980s, they shifted to viewing the ideal CEO as a charismatic, visionary leader. That inflated and, in Khurana's view, irrational belief about of the marginal value of the CEO (in the sense that then-available and subsequent studies have not found a sustained CEO effect) combined with the development of a free agent market in corporate leaders, whose leadership style came to be seen as more important than their knowledge of the specific business, to create the inflated compensation packages. Norms, in this story, most importantly play a role in defining what the role and contribution of the CEO is and in shaping the market for CEO services. Competitive bidding in that market, under skewed perceptions of the value of the manager, led to the explosion in compensation. In that story, LBOs would simply be the bleeding edge of this much broader and more basic shift in professional norms of management.

The literature on executive compensation social norms suggests that the social norms transition reflected three distinct elements: legitimation, conformism, and status competition. By “legitimation” I mean the social understanding of what is right and good, or appropriate, for a well-socialized person playing the role that I am playing to do. It involves prevailing ideas that shape integrated regulation

92“*The Social Responsibility of Business Is to Increase Its Profits*, by Milton Friedman,” accessed August 4, 2016, <http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html>.

93Bengt Holmstrom and Steven N. Kaplan, “*Corporate Governance and Merger Activity in the US: Making Sense of the 1980s and 1990s*” (National bureau of economic research, 2001), <http://www.nber.org/papers/w8220>.

94Ibid.

95Bengt Holmstrom, “*Pay without Performance and the Managerial Power Hypothesis: A Comment*,” *J. Corp. L.* 30 (2004): 703.

96Rakesh Khurana, *Searching for a Corporate Savior: The Irrational Quest for Charismatic CEOs* (Princeton, NJ: Princeton Univ. Press, 2002).

(the acceptance of external constraints as internally given)⁹⁷—they convert the “is” of conformism into the “ought” of “if I do this like everyone else, I am doing the right thing.” By “conformism” I mean that I want to blend in, be like others. It involves an exercise in benchmarking my own behavior to that of others, and conforming my practice to what I perceive to be “normal,” rather than necessarily what I consider to be “right,” as with legitimation. When various commentators on board dynamics in the 1990s surrounding executive compensation say that boards started to aim for their CEO to be in the top quartile of remuneration, they weren't saying “we want our CEO to be the highest paid;” or “we want to pay our CEO a calculated fraction of his marginal value;” they were saying “we want to be, and to be seen to be by both the executive and the markets, as paying compensation at the high end of the normal range.” By “status competition” I mean that some people, perhaps many or most, are driven to some extent by being not only like others (conformism), but being, and being perceived to be, superior to others. We can think of the three components as interacting to cause a ratchet effect. Some actors demand a particularly high salary as a mark of status. This salary then sets a baseline against which the conformists measure the range of plausible salaries, and adjust upwards. Changes in perceptions of the legitimacy of such and so a level of compensation, in turn, makes it easier for boards and CEOs to go to sleep at night secure in the knowledge that what they did is right and good. When they wake up the next day, the table is set for the next turn of the ratchet. Moreover, once boards internalized the idea that by setting a CEO's compensation they were signaling to the market their insider's view of the CEO's quality, they had to aim for some above-average number so as not to signal doubt. Once they did so, the markets in turn interpreted that high salary as a signal that the board had private information that the CEO was a good leader, and rewarded the firm with better stock performance. The academics seeking to study whether stock-based compensation took the rising stock price as evidence that higher stock option-based compensation was in fact a good predictor of higher quality management, which in turn supported academic literature that further legitimated the higher compensation levels. Again, legitimation, conformism, and status competition fed back in a cycle that offers some explanation for how executive compensation could have risen over 1200 percent over a 20 year period that saw lower levels of productivity gains than did the preceding two decades.⁹⁸

The cultural construction of the superstar salary: From Galbraith's parsimony to the Economics of Superstars, through Karim Abdul Jabbar and Barbara Walters

By 1981, the idea of a “superstar salary” was a sufficiently familiar concept that it formed the basis of an academic article in the *American Economic Review* entitled *The Economics of Superstars*,⁹⁹ which create the template for the “winner-take-all markets” justification of the high salaries in at the very top of income distribution. A study of how the term “superstar” emerged in American elite culture, however, offers a window into the legitimation and normalization of multimillion-dollar compensation packages, and locates the transition in the mid- to late 1970s, just in time to combine with the explosion in the financial industry that led to the LBO and merger spike in the 1980s and the take-off in stock option compensation.

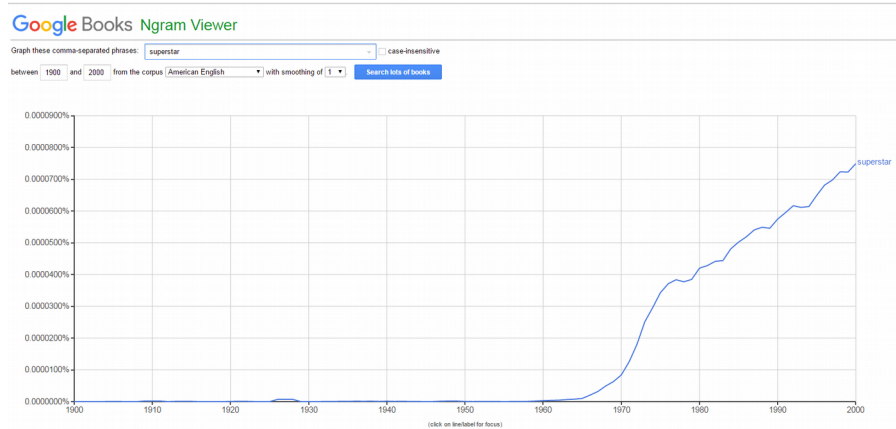
Consider the shape of increase in use of the term “superstar” across books in American English by looking at a Google Ngram of the term. Google Ngram allows users to capture the relative prevalence of different words in a massive corpus of books scanned into Google's servers stretching

⁹⁷Deci & Ryan 2001.

⁹⁸“CEO Pay Continues to Rise as Typical Workers Are Paid Less.”

⁹⁹Sherwin Rosen, “The Economics of Superstars,” *American Economic Review* 71, no. 5 (December 1981): 845–58.

back to the 18th century. The results can be quite sensitive to the selected phrases, and should be taken with a grain of salt, but very stark changes do offer at least a broad glimpse at changes in how language is used in published writing. It seems clear that the term “superstar” is largely unused in books before the mid-1960s, but rises dramatically throughout the mid-1970s.



To get a clearer view of what happened to this term, I analyzed all mentions of the word “superstar” in the *New York Times* archive prior to and including 1981, the year of Rosen's academic publication and the onset of the LBO movement. The word first appears to describe NHL player “Eddie Shore, Boston Superstar” in a December 16, 1936 article.¹⁰⁰ It is used scarcely, and remains largely a sports reference until 1965. Of the 62 times the term appears between 1936 and 1965, over fifty of the references are to athletes or, in rare cases, sports managers. Twice it refers to Hollywood stars, a few times in the 1950s to a kitchen appliance, a Lufthansa airplane, or a term in astronomy. The first radically new use of the term occurs in the society pages on July 26, 1965, in reference to Edie Sedgwick, described as “having been appointed Mr. Warhol's 'escort and Superstar’”.¹⁰¹ The next reference outside of sports is again to Sedgwick, “the superstar of Andy Warhol's underground movies,”¹⁰² and then in 1966 several more times, all in relation to Warhol's then-current female “superstar.”¹⁰³ These stories leave little question that Warhol is the person who appropriates the term from the sports pages and transposes it to the art and society scene. In 1967, the term that originally

10015,000 See Bruins Top Americans In Overtime Game at Boston, 5-3; Goldsworthy and Bun Cook Tally Within 62 Seconds to Decide the Battle After Chapman Ties Count -- Officials Prevent Free-for-All When Shore Draws a Penalty. 'scored every time one of them left i the ice, on shots by Charley Sands, Red Beattie and Dit Clapper. Eddie Shore, the Boston **superstar**, was in action for the first i time in a month but he played only a minor part in the Boston December 16, 1936 - By The Associated Press - Print Headline: "15,000 See Bruins Top Americans In Overtime Game at Boston, 5-3; Goldsworthy and Bun Cook Tally Within 62 Seconds to Decide the Battle After Chapman Ties Count -- Officials Prevent Free-for-All When Shore Draws a Penalty."

101Marilyn Bender, Edie Pops Up as Newest Superstar, Monday July 26 1965 NYT.page 26.

102Over the Rainbow Room: Modness By ANGELA TAYLOR (); November 18, 1965, , Section food fashions family furnishings, Page 59.

103Oct 1966: [A Hubbub at Paraphernalia](#) October 06, 1966 - By ANGELA TAYLOR - film maker, wearing a black turtle neck sweater and black jeans enhanced by a silver-kid belt. Also there was Andy's new **superstar**, a Bostonian named Susan Bottomly, whom he has rechristened "International Velvet." [The Painting on the Dress Said 'Fragile'](#); dresses in the dime store." Ingrid **Superstar** Arrives He paused, looking thoughtful. "If Reagan can win, we can do paper dresses," he said, as Ingrid **Superstar** suddenly appeared on the platform. "Yes, that s Ilr November 11, 1966 - - Print Headline: "The Painting on the Dress Said 'Fragile'" (again, Warhol)

referred to Warhol's Underground superstars (one, conveniently, just called "Ingrid Superstar") starts to be applied on occasion to major movie stars, but the term remains overwhelmingly applied to athletes (as it will throughout the period). The art world is also the first place where the term is applied to an executive. A New York Times Magazine piece about the Metropolitan Museum's new director, former New York Parks Commissioner Thomas Hoving, opens with the words: "The biggest show at the Metropolitan Museum,' remarked an out-of-town curator recently, 'is on mezzanine, behind the door marked Director."¹⁰⁴ The transition from sports, to pop art, to management is mediated, appropriately enough, by the management of the preeminent art institute in the city.

By the early 1970s, the term migrates to cover a range of political figures. From Daniel Ellsberg¹⁰⁵ to Herbert Marcuse,¹⁰⁶ William F. Buckley¹⁰⁷ and the Henry Kissinger,¹⁰⁸ who will be repeatedly referred to as a "superstar" in the following years. The term is first seen in the financial and business columns in a story about George Schultz, entitled "President's Economic Superstar", with a major image of Shultz in superhero getup.¹⁰⁹ Interestingly, however, in a later article on Kissinger's limitations, it claims that "The explanation runs far deeper into the Kissinger style and substantive point of view. Economic issues cannot be handled by superstar solos. They require both political and bureaucratic consensus at home, sustained attention, and messy negotiation with a variety of leaders abroad, because the issues fuse a wide variety of interests on a wide variety of negotiating fronts."¹¹⁰ Ronald Reagan is identified as "the conservative superstar" in December of 1974.¹¹¹ Capturing the rising power of Saudi Arabia as oil prices rise, Sheik Admed Zaki Yamani is also added to the pantheon of superstars, described as "the superstar at every OPEC meeting" in a 1977 story about the decline of Saudi power.¹¹²

The convertibility of being a superstar into making million-dollar salaries also begins in the sports pages. The association first appears in a 1964 story about golfing superstar Walter Hagen, who was "the first man to make a million dollars from the sport and also was the first to spend a million,"¹¹³ although the reference here is to prize earnings over a lifetime, not salary. The next reference is, interestingly, not to the United States at all, but to bullfighters in Spain, and how television has made

104 Grace Gluek, *The Total Involvement of Thomas Hoving*, New York Times, Magazine, December 8, 1968, page 48.

105 <http://www.nytimes.com/1971/12/12/archives/a-month-in-the-new-life-of-daniel-ellsberg-the-new-life-of-daniel.html>.

106 <http://www.nytimes.com/1972/07/09/archives/counterrevolution-and-revolt-by-herbert-marcuse-138-pp-boston.html>

Just what the movement needed, an elder who isn't an adult, By BENNETT M. BERGER JULY 9, 1972.

107 [Does It Still Hurt, Senator?](#) with the daily commentaries of John Kenneth Oalbraith, the liberal economist, and William F. Buckley Jr., the conservative **superstar**. Unlike the notorious Buckley Gore Vidal confrontations during the campaign of 1968, these sessions July 23, 1972 - By JOHN J. O'CONNOR - Print Headline: "Does It Still Hurt, Senator?"

[View original in TimesMachine](#)

108 October 29, 1972 - -- BERNARD GWERTZMAN - Print Headline: "At Long Last, the End of the Tunnel?; Peace Plan" <http://timesmachine.nytimes.com/timesmachine/1972/10/29/93419546.html>

109 <http://timesmachine.nytimes.com/timesmachine/1973/05/13/issue.html?action=click&contentCollection=Archives&module=LedeAsset®ion=ArchiveBody&pgtype=article>. May 13, 1973 Edward Cowan.

110 Frede Bergsten, Mr. Kissinger: No Economic Superstar, Dec. 12 1973. <http://www.nytimes.com/1973/12/12/archives/mr-kissinger-no-economic-superstar.html>

111 <http://timesmachine.nytimes.com/timesmachine/1974/12/20/79886597.html?action=click&contentCollection=Archives&module=LedeAsset®ion=ArchiveBody&pgtype=article>.

112 Paul Lewis, *Waning Saudi oil power*, New York Times, June 27, 1979. <http://query.nytimes.com/mem/archive/pdf?res=9A00EEDB1239E732A25754C2A9609C946890D6CF>.

113 Arthur Daley, Sports of the Times, June 17, 1964. <http://www.nytimes.com/1964/06/17/sports-of-the-times.html>.

this “the era of the superstar who earns a million dollars a year from the bull ring alone.”¹¹⁴ In 1968, it appears in the context of discussing a proposed transfer fee, not salary, of NHL player Frank Mahovlich, apparently traded in order to head off an effort by players to organize a union.¹¹⁵ The first references to salary in the million-dollar range inflated the income by treating a multiyear contract as a single sum to peg the total value of the compensation, a still-common practice: The annual compensation is multiplied by the number of years of the contract so as to reach the million-dollar mark. The first such instance is a story about O.J. Simpson's being drafted by the Buffalo Bills in the American League, whereas Simpson preferred to be in the NFL and on the West Coast. The story suggests that the Bills will “placate O.J. with money, perhaps a million dollars in a multi-year contract.”¹¹⁶ A few months later, Lew Alcindor, later Karim Abdul Jabbar, agreed to a five year, 1.4 million-dollar contract from the Milwaukee Bucks of the NBA, and then turned down a competing offer from ABA team New York Nets reported as worth 3.25 million, although almost half of that was to be paid over a twenty year period beginning when the player was 41—essentially a pension plan.¹¹⁷ The practice of inflating the actual compensation by quoting the multi-year value seems to have normalized the association between superstardom and millions of dollars.¹¹⁸ But the social norms associated with raw market “value” remain, in the late 1960s, constrained. In that 1969 story, Abdul Jabbar was quoted as saying he was not willing to let a bidding war go on because he thought it “degraded the representatives of the N.B.A. and the A.B.A.” A year after Galbraith's characterization of the internal norms that constrained executives from awarding themselves unreasonably high salaries, a well-spoken sports star (admittedly, one with an unusually high level of social consciousness) still described a bidding war between two major commercial enterprises over his services as degrading to the parties involved. By the time a million dollar salary is actually on the table for a TV personality outside of sports seven years later, the ground has shifted. Barbara Walters becomes the first news anchor to break a million dollars, and her response is revealing about how norms had shifted. For Walters, her normative angst was about whether a serious person, as opposed to an entertainment or sports celebrity, could accept a million dollar contract. The bidding war between NBC and ABC was not part of the problem, it was instead her source of legitimacy.

Walters' five year, million-dollar-a-year contract made headlines on April 21, 1976.¹¹⁹ The story emphasized that “The contest between ABC and NBC for Miss Walters's services is significant in that it extends to the news realm of television the spectacular financial terms usually associated with entertainment stars.” The follow up piece, entitled “What makes Barbara Walters Worth a Million?”¹²⁰ rewards close study. It encapsulates the whole story of the social norms transformation of the 1970s. In the interview, the *Times* quotes Walters as saying:

114Robert Daley, *The Spaniards Discover Bullfighting*, August 29, 1965.

115Gerald Eskenazi, *Hockey Icy Relations*, March 5, 1968, p. 46.

116Dave Anderson, *AFL Stature to Boom if Buffalo Lands Simpson*, Dec. 10, 1968. <http://query.nytimes.com/gst/abstract.html?res=9902EEDA1230EF34BC4852DFB4678383679EDE&legacy=true>.

117Alcindor Rejects A.B.A.'s 3.2 Million dollar offer and will sign with Bucks. March 30, 1969.

118Another example from the era is the lumping of a 10 year contract into a 3 million dollar contract in Hockey. <http://www.nytimes.com/1972/06/25/archives/for-3million-will-hull-leap-3million-query-will-hull-take-bid-to.html>.

119Les Brown, *ABC News Offers Barbara Walters \$1 Million a Year*, <http://www.nytimes.com/1976/04/21/archives/abc-news-offers-barbara-walters-1-million-a-year-abc-offers-miss.html>. “either way (whether she leaves or stays at NBC) will make the highest-paid news personality in television history.”

120<http://www.nytimes.com/1976/05/02/archives/what-makes-barbara-walters-worth-a-million.html>.

“But it was not just the sadness of leaving NBC. It was all the publicity about the million dollars, a kind of publicity I've never been used to,” Barbara said. “I worried all night about public reaction. Some people were going to be resentful of me because of it. But my own feeling was, why should I quarrel about getting a raise? I didn't ask for it.”

The story describes Walters' process of justifying her salary to herself: “Most people, I found, were used to the idea of basketball players getting fantastic sums for a few ball games. My driver—we all have drivers and hairdressers on the show, there's nothing special about that—told me that none of his friends found it unseemly that ABC would pay me a million a year.” In this story, broad social norms accepted by normal people have changed, and they were changed by the sports stories about the million dollar athlete contracts. Walters's driver's friends wouldn't find her million dollar salary unseemly thanks to this change.

In addition to the broad popular perception, there was the question of elite, peer perspectives. “I know,” Walters is quoted as saying, “there are many who believe news people should be more pure than show-business people. They seem to feel that if you get a million bucks, you're a superstar. And if you're a superstar, you're show biz. And if you're show biz, you can't be pure and can't do justice to the news.” In this part of the interview, it's clear that the problem is not “common man” but elite peers. And for these peers, “serious people,” are not the same as the shallow show biz people who make a million dollars. There is still a vestige of a stark division between the glitz and serious work. But, “Her agent, Lee Stevens of the William Morris Agency, had put it well, she thought. Why, he observed, should good reporter get less on television than a good comedian when news executives at the networks don't get paid less than executives in other departments of the company?” Benchmarking kicks in to offer legitimation. What follows in the *New York Times* article is the basic theory that five years later would become academic journal work *Economics of Superstars*, and twenty years later in winner-take-all markets. “All right, then, what makes her—of all journalists—worth a million a year? “If that's what two networks think I should get,” she answered.” The bidding war is no longer degrading, as it was a few years earlier in the Abdul Jabbar story, it's just the verdict of the market.

The question was not for Barbara Walters herself to answer. Network television—a \$2.5 billion industry in which only three companies share—operates on a grander scale than most media. It responds, too, at every level, to the basic law of show business that governs the price of things: whatever the traffic will allow. To put it simply, the traffic has allowed Barbara Walters to be traded on the talent market for \$1 million a year because she possibly will boost the news ratings a notch or two. At the high stakes the networks play for, the investment of a mere million toward lifting ABC's long-static news ratings is a minor gamble, indeed. A television personality overnight can add hundreds of thousands of households to a program simply through his or her presence. The gain of a single rating point puts the newscast in 710,000 additional homes, where it may be watched by approximately 1.2 million extra people. At the rates paid for commercials on the network newscasts in today's market, the gain of a single rating point should mean a gain of at least \$1 million in revenues.

This is, in a nutshell, the entire winner-take-all markets hypothesis. But, as I already noted, because over-the-air TV actually declined over the decades since 1976, news anchor salaries offer a nice informal test for the winner-take-all markets hypothesis relative to the social norms story. Katie Couric's \$15 million a year as CBS news anchor in 2006 was set at a time that CBS reached about a

million households fewer than ABC did in 1976. Couric's salary was in line with then-prevailing top baseball salaries, for example, and higher, in inflation adjusted terms, than the salaries of both her predecessors, Dan Rather and Walter Cronkite, who had been anchors when CBS News was watched by almost twice as many households (and Rather's salary kept climbing as the program's viewership declined). If technologically-driven winner-take-all markets were the real explanation, then TV news anchors who saw technology diminishing their market reach should have seen a decline in their inflation-adjusted salaries, commensurate with the declining market-share of TV news. If labor markets are noisy, and social benchmarking to superstar entertainment salaries is driving the salaries, then one would expect the salaries to rise in correlation to other elite entertainer salaries, as in fact happened, rather than to decline with lower market reach of the medium.

By 1976, then, the cultural transformation had been more-or-less completed. The judgment of what the market will bear was now enough to legitimate any salary, and if market bidding set a price, then it probably reflected a reasonable judgment about what the person would bring to the company in terms of value. What remained now was to transpose that shift from the rarefied air of the media superstars—fluffy or serious—to the humdrum of board rooms and corporate suites. This, it turned out, did not take long.

The word “superstar” was first applied in a *New York Times* story to a business executive in May of 1976, referring to Michael C. Bergerac, CEO of Revlon who “two years earlier” had been “lured from the International Telephone and Telegraph Company by the late Charles H. Revson with a \$5 million contract including a \$1.5 million bonus just for coming aboard.”¹²¹ Both components of Khurana's story are present here: the free agent market for CEOs rather than internal promotion of people with deep knowledge of the firm, and the relationship between beliefs about that CEO and the superstar salary. The following year, this singular story begins to become generalized as the next reference in the *Times* to “superstar” in business identifies Michael Maccoby's book, *The Gamesman*, as a turning point in managerial theory. Maccoby, writing on the basis of 250 interviews with top executives at leading companies, focuses on a new type of corporate leader, the “gamesman”. Maccoby describes this new corporate leader as pursuing not riches but “fame and glory, the exhilaration of running his team and gaining victories. His main goal is to be known as a winner; his deepest fear is to be labeled a loser.” The sports metaphors abound, as the gamesman is described as “a team player but a would-be superstar,” among other paradoxically juxtaposed binaries, like “cooperative and competitive.” There are two reviews in the *Times*, one on January 30, the other on February 1st, 1977, and both emphasize the sports and superstar metaphor. The emphasis is on “teams that win competitions” inside the corporation and outside it; “All members of the gamesman's team win when he leads them over the finish line.”¹²² That same year, the net widens to cover others, and the tie between superstar, ego, and money marked ever-more starkly in a piece from April 17, 1977, *With Fees as Big as their Egos*,¹²³ discussing an adoring book by Norman Shreskey, *Masters of the Courtroom*, “The most celebrated of these superstar lawyers roar into alien courtrooms, trailing press clippings, aides-de-camp, photographers and rumors of awesome fees they receive. Their colossal egos and bantam rooster struttings become an integral, if unrecorded, part of the proceedings.” So it is part of a broader shift of treating “serious” professions as exhibiting superstar fees and egos, and demanding for

121Marylin Bender, *Revlon Puts on a New Face*, <http://www.nytimes.com/1976/05/30/archives/revlon-puts-on-a-new-face-michel-bergerac-brings-own-style-of.html>. Page 81.

122Robert Lekachman, reviewing Maccoby *The Gamesman*, January 30 1977.

123<http://www.nytimes.com/1977/04/17/archives/with-egos-as-big-as-their-fees-with-egos.html>.

these egos and fees a grudging or adoring acceptance, a shake of the head or a sprinkle of stardust, as it had for Hollywood stars or athletes.

By the end of the 1970s, inflation has hit not only the dollar, but the “superstar” designation as well. Routinization of superstardom is nowhere clearer than in a pair of humdrum stories about the retail and advertising businesses. One of the stories sounds like a cheap sales pitch to recruit mid-level sales executives:

Age, background and sex are no barriers, recruiters say, for talented people who have quickly, or over a period of time, racked up an impressive record. And they add that three types of superstars will be most in demand in the years ahead. These will be merchandising executives who can give a store directional impact; real-estate executives who can pinpoint viable, strategic store sites, and marketing or sales-promotion experts skilled at positioning a retailer in a major or minor metropolitan area.

The hunt for these superstars — in an industry until recently noted for being long on hours and short on rewards — is one of the more dynamic elements pointing to a bright career future in retailing. The most successful of the candidates in this enterprise have achieved impressive incomes not unlike those in the entertainment field or, in a brief time, have commanded impressive salaries that will put them on the road to superstar status.¹²⁴

The segment captures beautifully the banal routinization of the terms superstar and its direct tie-in to compensation. In a dozen years, “superstar” had transitioned from Andy Warhol's models and million dollar packages for Karim Abdul Jabbar, to “real-estate executives who can pinpoint viable strategic store sites” and whose “impressive salaries” “put them on the road to superstar status.” The very last sentence, of course, inverts the relationship. It is the salaries that put the recruits on the path to superstar status, not the other way around.¹²⁵ The circuit is closed, and the social-cultural background set for the explosion of compensation in finance and executive compensation in the “Greed is Good” days of *Wall Street* and *Bonfire of the Vanities* in a May, 1981 story, which describes “superstar analysts” on Wall Street, and the fierce competition among Wall Street firms for top talent, leading to compensation packages in the \$125,000 to \$200,000, and describing how these were, in turn, influencing the salaries of newly minted MBAs who were seeing salaries go up to the \$30,000 to \$50,000 total compensation package.¹²⁶

By 1981, as financial deregulation and the spike in interest rates of the 1980s intended to restrain inflation had created the conditions for the M&A and LBO market for corporate control, the background cultural norms and expectations reflecting both Khurana's observations about the shift in

124Isadore Barmash, *The New Employer*, NYT Oct. 14 1979. <http://www.nytimes.com/1979/10/14/archives/the-new-employer-a-boom-in-retailing.html>.

125The same reporter, reporting on a merger of advertising agencies, quotes a vice chairman of the newly created advertising chain describing one of the refers to the company's new executive vice president and creative director in the New York office as the company's “superstar in New York.” Isadorah Bamash, *A Flurry of Top-level Job Shift*, August 11, 1980.

126Kenneth B. Noble, *Brokers Vie for Top Analysts*, May 28, 1981. <http://www.nytimes.com/1981/05/28/business/brokers-vie-for-top-analysts.html>.

what directors were looking for in executives, and Holmstrom and Kaplan's argument about the norms set in the LBO market are ready in place.

Greed is Good: LBOs, Shareholder Value, and the legitimization of oligarchic extraction through rational actor theory

The 1980s saw unusually high levels of hostile (a bid opposed by the firm's management) and debt-financed mergers and acquisitions. Almost one-quarter of all major firms in the United States were the subject of a hostile takeover attempt, and another slightly more than a quarter received a takeover bid supported by management.¹²⁷ Another seven percent underwent a major restructuring to avoid the threat of takeover. In all, over 57% of firms studied were substantially affected by takeovers. Moreover, much of this activity was done by taking on debt, rather than issuing equity or stock. Holmstrom and Kaplan calculated that between 1984 and 1990 3% of U.S. stock was retired every year, retiring over half a trillion dollars worth of equity in six years and turning it into debt.¹²⁸ Central to this model of replacing equity with debt were transactions of firms going private—retiring the public equity and replacing it with debt, mostly junk bonds—corporate debt that was not rated “investment grade.” Half the junk bond market was takeover related.¹²⁹ More than one-third of these debt leveraged buyouts of the latter half of the 1980s resulted in defaults, “some spectacular.”¹³⁰ There is, as there always is, an efficiency or productivity story to be told about the 1980s. That story roughly states that long-standing failures of management and little competition in highly regulated industries meant that there was tremendous value locked inside firms that was not being used efficiently. Deregulation in the 1970s and 1980s, global competition, and improved technology made the inefficiencies more evident and easier to unlock, but managements were too slow to respond. The market for corporate control—the takeover market—stepped in to take these firms over, restructure them, and release that value.¹³¹

To make this efficiency story work, one needs an explanation for why so many of the deals ended up in default. Holmstrom and Kaplan suggest that those who joined the LBO and acquisition markets in the latter 1980s were copycats of the successes of the early 1980s, and just calculated poorly what the proper price was, allowing the acquired company shareholders to capture all the productivity gains in the initial price. This explanation requires, however, that these hapless investors, duped into paying too much, nonetheless systematically paid too much *for the right firms*—those whose acquisition itself was efficient. But there is no reason to think that the investor's error occupied the Goldilocks zone—just wrong enough to pay too much, but not wrong enough to pay for the wrong company (one whose acquisition is an instance of rent extraction, not efficiency-enhancing). I will return, in the discussion of financialization below, to the political economy story that involves deregulation, globalization, and technology, alongside organizational strategy, that drove the financial markets to complement the trends in executive compensation and provide the primary vector of executive compensation growth. This change created a sufficiently large shock to prevailing practices that it created new opportunities for rent extraction. On the background of this shock, power and

127Mitchell, M. and H. Mulherin. 1996. “The Impact of Industry Shocks on Takeover and Restructuring Activity.” *Journal of Financial Economics*. pp. 193-229.

128Holmstrom and Kaplan, “Corporate Governance and Merger Activity in the US,” 4.

129Ibid., 5–6.

130Ibid., 8.

131Holmstrom and Kaplan; Jensen 1993; Murphy 2012. see above.

shifting practice norms allowed a small number of actors taking advantage of a large number of actors—workers, communities where plants were shut down, hapless investors in the junk bond markets looking for places to park their money in a new and unfamiliar financial environment—to extract tremendous value to themselves independently of whether there was, in fact, a productivity increase. But for now I will focus on the high-culture academic and professional literature complement to the popular culture emergence of the idea of the superstar and the winner-take-all market.

Whether or not one accepts the efficiency story behind the M&A and LBO activity in the 1980s, Holmstrom and Kaplan make a persuasive case that the structure of M&A activity in the 1980s fundamentally altered the landscape of executive compensation.¹³² First, LBOs in particular were cash poor, and their compensation model was therefore often a promise of future share in the upside for management. These became the first major site of large stock-based compensation packages. Second, stock-based compensation could be used to sweeten the deal for management of the acquired companies, so as to constrain their resistance to the takeover. By the 1990s, this model of stock compensation had become so widespread that even when merger activity increased, it was much less often hostile than it had been in the 1980s. Finally, investors involved in this M&A activities, like Carl Icahn or T. Boone Pickens, among several others, and private equity firms, most prominently Kohlberg Kravis Roberts & Co, often saw themselves as superstars, and likely looked for managers who themselves fit the superstar model of the executive that had developed over the course of the 1970s. They were, after all, going after firms that they saw as mismanaged, and were looking to replace the managers with visionaries who would release all the value stored in the firm. These superstars, in turn, could command high stock-based compensation for the supposedly high value that they, individually, could bring to the firm. In combination, these factors meant that the CEOs and top executives in the LBO market became the new benchmark for executive compensation. They played the role the highest paid athletes played a decade earlier, providing a new benchmark against which other compensation packages could be measured, and the new standard for how to structure a compensation package—particularly how to use stock options as a central part of the package that provided the vector through which executive compensation took off. Like a smooth engine, once the starter started the ratcheting mechanism, it was no longer necessary. Once LBOs created the new benchmarks for size and structure of compensation, the “normal” dynamics of social benchmarking could take over and rapidly expand the compensation levels and models to ever-wider portions of the economy, and the normal dynamics of ratcheting could assure that every board of directors setting its firm's compensation would increase that benchmark incrementally over time. The central place of stock options, in turn, made sure that the increase would not be gradual, but would rapidly converge on the growth rate of the stock market during a period of bubble-driven returns.

The LBO market offers a plausible pathway for explaining how a benchmarking process of social conformism can shift from one stable equilibrium to a new equilibrium of higher and rapidly growing compensation. It does not, however, tell the whole story. In particular, it does not tell the story of how legitimation happens, or the sense of what is appropriate for a person like me, to be making. Here, the general cultural emergence of the superstar offers some insight, but is strongly complemented by more domain-specific changes in the intellectual frame or ideology, as well as in the political economy and psychology of stock options. In particular, the rise of “shareholder value,” and its associated “agency theory” offered an elite, academic justification for high stock-based compensation that allowed executives and boards to believe that by structuring the compensation as they did and

132Holmstrom and Kaplan, “Corporate Governance and Merger Activity in the US.”

setting it at its new high levels they were doing affirmative good in the world—they were assuring that the companies were doing precisely what they were supposed to be doing. And the use of stock options camouflaged the magnitude and rate of increase in compensation from both outside observers and from the directors themselves, so as to limit both external and internal pressures from whatever social norms-based constraints may still have existed by the 1990s.

At the level of ideas or framing, the most important contributions were the shift to “shareholder value” and the development of “agency theory” as an implementation of the more general rise of rational actor theory. These theories were the meso-level implementations in the business school or management science domain of the macro-level rise of neoliberalism and the rational actor theory. The foundation of the argument is in a *New York Times* comment by Milton Friedman, in 1970, entitled: *The Social Responsibility of Business is to Increase its Profits*.¹³³ The first paragraph makes the stakes clear:

The businessmen believe that they are defending free enterprise when they declaim that business is not concerned "merely" with profit but also with promoting desirable "social" ends; that business has a "social conscience" and takes seriously its responsibilities for providing employment, eliminating discrimination, avoiding pollution and whatever else may be the catchwords of the contemporary crop of reformers. In fact they are—or would be if they or anyone else took them seriously—preaching pure and unadulterated socialism.

Instead, “In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom.”

Friedman's public intervention was a reflection of the maturation of neoliberalism in American political and policy debate. Alongside Friedrich Hayek, Friedman had been a founder of the Mont Pellerin Society in the 1940s and an intellectual leader of a fundamentally critical response to the early twentieth century rise of Progressivism in the U.S. and New Liberalism in the UK.¹³⁴ Both these earlier movements, took the possibility of benevolent government intervention as practically feasible and necessary in the teeth of the failures and depredations of 19th century *laissez faire* capitalism. They combined a recognition, born of repeated boom and bust cycles and reinforced by the Great Depression, that markets failed on their own terms, and had social inequality side effects that were immoral, on one hand, and highly destabilizing politically—as Hitler and Mussolini's rise amply exhibited. Their success became the dominant ideology, accepted not only by progressives and liberals but by post-War conservatives on both sides of the Atlantic as well, throughout the “Glorious Thirty” or “Golden Age” of capitalism.

Hayek, Friedman, and their many collaborators took a different lesson from the rise of authoritarian regimes both fascist and communist: that only decentralized coordinated action in markets could properly organize as complex a system as modern market society, and that efforts at planning,

¹³³Sept 13, 1970. <http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html>

¹³⁴Jones, *Masters of the Universe*.

including well-intentioned progressive planning, ultimately resolve to control and tyranny. While they remained at the margins of academic and policy circles throughout the 1940s until the 1970s, Hayek and Friedman built a network of academics, primarily economists, and organizations. Initially funded by ideologically-committed individuals, like Leonard Reed, or the William Volcker Fund and later the Olin Foundation, the neoliberals built organizational capacity through think tanks and special-purpose programs within academia. In some cases, as with Henry Manne's successes in fundraising for the law and economics movement, these involved direct appeals to the self-interest of companies like ITT or U.S. Steel that had direct interest in loosening antitrust law to fund a movement that would nudge law in that direction.¹³⁵ These appeals fit well the changed political program of business organizations in the 1970s.¹³⁶ Some of these organizational beachheads were located in traditional academic departments with a critical mass of members who then influence future appointments to build a “school.” The Chicago economics department was one such place, James Buchanan and George Tullock at the Virginia Polytechnic Institute, or later at George Mason University, and the investments of the Olin foundation in supporting the establishment and expansion of law and economics programs at the major law schools.¹³⁷ Others were special-purpose centers, often funded by ideologically-driven or business-driven benefactors, that offer a home within academia but apart from the normal politics of academic appointments. Hayek's own appointment at Chicago's Committee on Social Thought, and Aaron Director's leadership of the Free Market Study program at Chicago are such models; Henry Manne's Law and Economics Center, which played an absolutely central role in making law and economics a respectable discipline in the 1970s, was another major example.¹³⁸ To this “inside” strategy the movement added think-tanks. These housed scholars whose primary focus was translational work, or academics when they were taking their academic work and translating it for consumption of policymakers and elite opinion makers, as Stigler and Friedman's paper on rent control published by the Foundation for Economic Education in 1946 exemplifies. The American Enterprise Institute and FEE were soon joined by the Heritage Foundation, The Cato Institute, and many others whose business model was to attract funding to support a steady flow of papers and events criticizing regulation and redistribution at a detailed level of analysis of both policy and politics. In the United Kingdom, the original equivalent was Antony Fisher's Institute for Economic Affairs, also directly influenced and inspired by Fisher's conversations with Hayek. To these think tanks, the movement added even more public-facing programming to educate both elites—such as “Pareto in the Pines” used to teach legal scholars the economic outlook or its equivalent for judges—and mass audiences, as Milton Friedman's *Newsweek* column and later television show did so remarkably. By moving from big ideas to technically-well-worked-out details, from academia to think tank to popular culture, and from idea development to education and training, the movement was able to create a large cadre of elite actors who, some more consciously than others, had come to adopt a worldview, a way of interpreting the world, that saw markets as, at root, efficient, and government planning as doomed to fail, corrupt, and tending to tyranny.

While Friedman's 1970 New York Times piece wore the raw political orientation of the critique of mid-century managerial capitalism on its sleeve, it received a more academic, technocratic, and a-political restatement five years later, when Jensen and Meckling introduced agency theory and

135Teles, *The Rise of the Conservative Legal Movement*, chaps. 4, 6. (ITT mentioned in an interview on page 125; Manne expressly describes his fundraising efforts in terms of the long term interests of these companies in antitrust in particular).

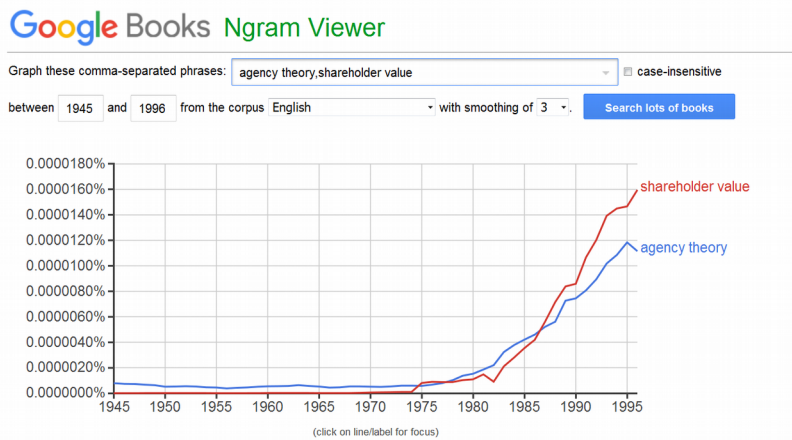
136Hacker and Pierson, *Winner-Take-All Politics*, 2010.

137Teles, *The Rise of the Conservative Legal Movement*, chap. 6.

138Ibid., chap. 4.

shareholder value as the cutting edge of rational actor theory applied to the business organization.¹³⁹ Agency theory is a general claim that as between any two contracting parties, one is an “agent” of the other, the “principal,” with regard to fulfillment of his or her duties. The “Agent” will always try to get the most out of the deal, by performing only enough to satisfy the principal, while appropriating as much as possible of the value to themselves. The contracts therefore have to align the incentives of the agent with those of the principal. In the case of firms, Jensen and Meckling start with a simple model of an entrepreneur who enjoys both the profits and the perquisites of ownership—the office, car, good relations with employees, respect in the community and so forth. When the entrepreneur sells stock, he no longer gets the full benefit of the profits, so he starts shifting, to the extent he can, some of the effort toward the perquisites he does not share with other shareholders. He enjoys all the benefits of the corporate retreat, or jet, or free food, but shares the costs to profits with the shareholders. And so the split emerges, and executives in publicly owned companies with dispersed shareholders are just a more extreme case of the same problem. Executives will do so at the expense of the true owners of the corporation—shareholders—unless their incentives are properly lined up. In an era where executives are paid like bureaucrats, they function as bureaucrats, making decisions to grow their organizations and secure their sinecures, extract perquisites to the extent they can get away with it, rather than making their businesses as profitable as they can be. Making the firm as economically efficient as it could be required focusing on maximizing returns to shareholders, and doing so, in turn, required aligning the compensation models of executives with that goal. Corporate executives should be paid so that their pay increases with share value, and when they are maximizing shareholder value they are performing their best role and making society as productive as it can be. The private benefit gets converted into social welfare generally.

A Google Ngram of the terms “agency theory” and “shareholder value” from 1945 to 1996 shows very clearly that the terms emerge in the late 1970s, and then take off in the early 1980s. After 1996, agency theory more or less stabilizes in use, while shareholder value continues to grow.



139Michael C. Jensen and William H. Meckling, “A Theory of the Firm: Governance,” *Journal of Financial Economics* 3, no. 4 (1976): 3-5-360.

Jensen and others continued to work on this theory of the firm, but the most influential next step was Harvard Business Review article that Jensen co-authored with Kevin Murphy based on joint academic work they were soon to publish, entitled *CEO Incentives—It's Not How Much You Pay, But How*.¹⁴⁰ The piece starts with a derisive reference to “Political figures, union leaders, and consumer activists will issue now-familiar denunciations of executive salaries and urge that directors curb top-level pay in the interests of social equity and statesmanship.” Instead, Jensen and Murphy argue that “The critics have it wrong. There are serious problems with CEO compensation, but 'excessive' pay is not the biggest issue.” “On average,” they reported their findings, “corporate America pays its most important leaders like bureaucrats. Is it any wonder then that so many CEOs act like bureaucrats rather than the value-maximizing entrepreneurs companies need to enhance their standing in world markets?” In other words, the political pressures to lower executive compensation are the cause of America's decline in the world of business. The core of the argument is:

Compensation policy is one of the most important factors in an organization's success. Not only does it shape how top executives behave but it also helps determine what kinds of executives an organization attracts. This is what makes the vocal protests over CEO pay so damaging. By aiming their protests at compensation *levels*, uninvited but influential guests at the managerial bargaining table (the business press, labor unions, political figures) intimidate board members and constrain the types of contracts that are written between managers and shareholders. As a result of public pressure, directors become reluctant to reward CEOs with substantial (and therefore highly visible) financial gains for superior performance. Naturally, they also become reluctant to impose meaningful financial penalties for poor performance. The long-term effect of this risk-averse orientation is to erode the relation between pay and performance and entrench bureaucratic compensation systems.

Are we arguing that CEOs are underpaid? If by this we mean “Would average levels of CEO pay be higher if the relation between pay and performance were stronger?” the answer is yes. More aggressive pay-for-performance systems (and a higher probability of dismissal for poor performance) would produce sharply lower compensation for less talented managers. Over time, these managers would be replaced by more able and more highly motivated executives who would, on average, perform better and earn higher levels of pay. Existing managers would have greater incentives to find creative ways to enhance corporate performance, and their pay would rise as well.

These increases in compensation—driven by improved business performance—would not represent a transfer of wealth from shareholders to executives. Rather, they would reward managers for the increased success fostered by greater risk taking, effort, and ability. Paying CEOs “better” would eventually mean paying the average CEO more. Because the stakes are so high, the potential increase in corporate performance and the potential gains to shareholders are great.

¹⁴⁰The academic article was Jensen and Murphy, “Performance Pay and Top Management Incentives.” The HBR piece was *CEO Incentives—It's Not How Much You Pay, But How*, <https://hbr.org/1990/05/ceo-incentives-its-not-how-much-you-pay-but-how>.

The most important recommendation was to give the executives as large a stake in company stock as feasible, so that their personal wealth will fluctuate meaningfully with the value of the company's shares. The ideological infrastructure, or frame, for the increase in stock option grants was set. Executives who demanded, and directors who awarded, stock-based compensation, were doing the right thing, they were fulfilling their fiduciary duties to shareholders because this was precisely how to assure that the executives did the right thing by the shareholders, and doing the right thing by the shareholders was, in turn, doing the right thing for society—maximizing the welfare effects of business activity and strengthening American business in the face of increasing global competition. And, as later studies of the explosion of executive pay make amply clear, it is indeed stock options in the 1990, and restricted stock (functionally similar grants) since the mid-2000s were, indeed, the overwhelming cause of the explosion in executive pay.¹⁴¹

It is remarkable how close the elite-oriented articles of Jensen and Meckling and Jensen and Murphy are to the famous movie speech by Gordon Gekko, the key figure in *Wall Street*, which came out three years before the Jensen and Murphy HBR article. Gekko is the quintessential corporate raider of the 1980s, personifying the M&A and LBO culture, who is about to take over the company, strip it of its assets, and lay off the employees, including the father of his plucky protege who will, as in Hollywood he so often does, save the day and bring Gekko down. But not now; not yet. Here Gekko is at his most powerful, persuading the shareholders that they should sell to him because management has been denying them the real value of the company.

Well, ladies and gentlemen, we're not here to indulge in fantasy, but in political and economic reality. America, America has become a second-rate power. Its trade deficit and its fiscal deficit are at nightmare proportions. Now, in the days of the free market, when our country was a top industrial power, there was accountability to the stockholder. The Carnegies, the Mellons, the men that built this great industrial empire, made sure of it because it was their money at stake. Today, management has no stake in the company!

All together, these men sitting up here [Teldar management] own less than 3 percent of the company. And where does Mr. Cromwell put his million-dollar salary? Not in Teldar stock; he owns less than 1 percent

You own the company. That's right -- you, the stockholder

And you are all being royally screwed over by these, these bureaucrats, with their steak lunches, their hunting and fishing trips, their corporate jets and golden parachutes.

...

Teldar Paper, Mr. Cromwell, Teldar Paper has 33 different vice presidents, each earning over 200 thousand dollars a year. Now, I have spent the last two months analyzing what all these guys do, and I still can't figure it out. One thing I do know is that our paper company lost 110

141Frydman and Saks, "Executive Compensation," 2106–8; Murphy, "Executive Compensation: Where Are We, and How We Got Here."

million dollars last year, and I'll bet that half of that was spent in all the paperwork going back and forth between all these vice presidents

The new law of evolution in corporate America seems to be survival of the unfittest. Well, in my book you either do it right or you get eliminated.

In the last seven deals that I've been involved with, there were 2.5 million stockholders who have made a pretax profit of 12 billion dollars. Thank you.

I am not a destroyer of companies. I am a liberator of them!

The point is, ladies and gentleman, that greed -- for lack of a better word -- is good.

Greed is right.

Greed works.

Greed clarifies, cuts through, and captures the essence of the evolutionary spirit.

Greed, in all of its forms -- greed for life, for money, for love, knowledge -- has marked the upward surge of mankind.

And greed -- you mark my words -- will not only save Teldar Paper, but that other malfunctioning corporation called the USA.

The argument is almost identical. What ails American business is that executives are paid like bureaucrats, instead of having a real stake in the company. These executives fleece shareholders by getting bloated salaries and perquisites for doing nothing, instead of being exposed to the clarifying power of tying their own personal wealth to the fate of shareholders. "Greed is good. Greed works." And rather than, in the framing of Hollywood in *Wall Street* being described as destructive, in the Jensen and Murphy article this argument *is* what high class, technocratically-trained economists publishing in the most prestigious business publication spanning the academic and business worlds are recommending. "Greed is good" is no longer a warning of declining norms; it has become the way that well-trained and well-socialized executives and directors should see the world, while the whining of "uninvited but influential guests" is nothing more than that.

If we tried to pull the elite and popular cultural shifts together, we can combine with the managerial power hypothesis and the social norms hypothesis, but distinguish between the social norms shifts that were driven by elite knowledge production and those driven by popular culture. Both systems shifted the dynamics of legitimation, benchmarking, and status competition in the late 1970s to early 1980s, in a way that then explains the timing of the increase in executive pay, and relocates the main causal drive from boardroom power to social norms and knowledge production. Managerial power becomes an implementation vector rather than a cause, while changes in broad social norms and narrower expert beliefs become the cause.

To this point, the story I have told is very much a story of norms and ideas. But that is not the whole of the story. These more general societal trends were complemented by discrete lobbying efforts on discrete institutional levers that directly impacted the dramatic rise of executive compensation.

Norms, law, and politics: the curious incident of the invisible stock options

The social norms that stoked and legitimated the ratcheting dynamic in executive compensation operated in an institutional context. Just as the politics and institutional changes in the 1940s led to a change in social norms toward wage compression, so too did the shift in social norms to permit high wage dispersion in the form of superstar salaries require an institutional context. The interdependence between norms and institutions is nowhere clearer than in baseball salaries. Baseball players, who were every bit as subject to superstar reporting as other athletes in the 1960s and 1970s, saw no increase in top salaries for decades after Babe Ruth. But baseball salaries suddenly took off in 1976,¹⁴² in a direct response to the much more humdrum explanation that players won an arbitration decision that killed the reservation clause, and created the free agent market in which players had vastly more bargaining power than they had before 1976. The top salary doubled in one year, and kept climbing at dizzying rates thereafter.

The social norms system developed in corporate board rooms and in the internal normative universe of managers did not operate in a vacuum. Gekko was, after all, the villain in *Wall Street*. By the election cycle of 1992, executive compensation was a hot issue on both left and right. In his political history of executive compensation, Murphy quotes Dan Quayle as calling corporate boards to “curtail some of the exorbitant salaries paid to corporate executives,” and Pat Buchanan arguing that “you can't have executives running around making \$4 million while their workers are being laid off.”¹⁴³ Democratic candidates Bob Kerry, Paul Tsongas, and most importantly, of course, Bill Clinton all focused on excessive pay and threat to workers. Clinton in particular promised to define \$1 million dollars as a cap on deductability—anything above that would have to be taken out of post-tax income. The legislative process, however, produced a less crisp constraint than originally proposed on the campaign trail. The most important difference was that Internal Revenue Code section 162(m) would cap deductability at \$1 million for non-performance pay, but that firms could continue to deduct pay as long as it was awarded by a board compensation committee that would then certify that the goals had been met, and that the compensation was disclosed to shareholders.

The compromise embodied what by then had established itself as the “correct” technocratic solution to executive pay—pay for performance. This exception turned out to swallow the whole, and indeed, on the background of shifting social norms, affirmatively exacerbated the benchmarking and ratcheting effects. It meant that \$1 million base was the “new normal,” leading many companies to raise their base compensation to this level. Second, IRC 162(m) operated in conjunction with a rule change by the Securities and Exchange Commission, which in 1992 revised its reporting requirements for executive compensation in order to facilitate shareholder oversight. Top salaries were now to be reported in an easy-to-read table. Both changes in law were honestly (we assume) intended to control

142Michael Hauptert, MLB's annual salary leaders, 1874-2012, <http://sabr.org/research/mlbs-annual-salary-leaders-1874-2012>.

143Murphy, “Executive Compensation: Where Are We, and How We Got Here,” 75.

executive compensation. But on the background of a ratcheting social dynamic, they interacted to cause the most rapid increase in executive compensation of any other period since 1980. The \$1 million based set a benchmark; and the high visibility of executive compensation in peer companies informed the conformism and status competition dynamics. Executives demanded to be matched to others like them, and boards were now able to use public information to signal that they thought their executive was better than average. On the background of both external and internalized social norms that saw higher pay as associated with higher performance and legitimated the practice, boards took the invitation to tweak what they could control—high pay—in order to achieve what they wanted—higher returns. Market investors, in turn, on the background of the same state of shared knowledge, interpreted such compensation packages not as a sign of a weak board, but as a sign of a high quality CEO.

There is an interpretation of this story that absolves the main actors of responsibility. They were simply going with the flow. But the contours of behavior remained constrained and shaped by laws and practices, and these, in turn, were shaped by self-conscious lobbying. Nowhere is this dynamic clearer than in the fierce political battle over that most arcane and non-sexy of technocratic domains: accounting standards. Specifically, the question of how companies reported the costs of granting stock options to executives. Under an October 1972 decision of the then-authoritative standards setting body for accounting, the Accounting Principles Board, stock options whose number and strike price was fixed at the time of grant should be accounted for as compensation equal to the value of the difference between the share price on the day of grant and the strike price at that date. This meant that granting a traditional stock option was accounted as imposing no compensation cost on the firm.¹⁴⁴ The following year, Fischer Black and Myron Scholes published their groundbreaking academic work on calculating the value of options,¹⁴⁵ launching a flurry of academic activity, and providing the intellectual foundations for what would become the flourishing market in options and other derivatives. It took the accounting standards board, by now renamed the Financial Accounting Standards Board (FASB) a decade to assimilate the lessons of academic work on option valuation, and between 1984 and 1986 the FASB developed proposals for valuing, and accounting as compensation costs, for stock options. Doing so then would have aligned accounting standards with how firms and investors actually valued stock options. But it took twenty years, and the accounting scandals of Enron and Worldcom, to break down the political opposition that had prevented stock options from being accounted properly. As Murphy's political history documents, from at least 1986 to 2006, the years when executive compensation exploded, companies were granting stock options under accounting standards that were known to camouflage the real compensation costs to firms; standards that purposefully distorted the cost of options through the consistent and effective deployment of political power to squelch professional judgment in the standards-setting process.

In 1986, when the FASB first proposed new draft standards requiring firms to report the fair market value of options they granted as a compensation expense, the opposition was within the business community. The major accounting firms, electronics and pharmaceuticals industry associations, and financial executives and venture capitalists all opposed the change, and the FASB relented. In 1991, Senator Carl Levin of Michigan introduced a Corporate Pay Responsibility Act in Congress to support the FASB, but the proposal got nowhere. In 1992 the FSAB again proposed a

144Ibid., 59–60.

145Black Scholes 1973

change that would require options to be expensed at their market value, drawing concerted political opposition. The primary opposition came not from Wall Street or other traditional companies, but from the high tech companies that were using stock options as seemingly “free” money with which to pay employees. An action memo to Silicon Valley employees captures the gist of the argument:

“Your Stock Options/Stock Purchase Plans are Threatened because of 7 Bureaucrats. These 7 FASB Bureaucrats plan to enact a proposal that will eliminate broad-based stock option plans. **Your** security and the Valley’s security are threatened.

What sets Silicon Valley apart? **Stock options.** Why do we get the best people? **Stock options.** What’s the one incentive left? **Stock options.**”¹⁴⁶

On this background, Democrats representing these constituents, not Republicans, led the charge. Senator John Kerry, opened his remarks on the Senate floor directly echoing the technology industry:

in my State, just as in Silicon Valley, stock options serve as a fundamental means of financing the start-up of new companies. Employees forego salary and benefits in return for stock options. In doing so they bind themselves to the firm for a period of several years, and commit themselves to the goal of all investors: the company's success. Stock options allow the company to reserve critically needed cash for other vital needs of a new or emerging company: for research and development, for marketing, and for getting a new product out the door.¹⁴⁷

Senator Dianne Feinstein of California introduced a bill to defund the FASB, and Senator Joe Lieberman introduced a bill that would have eliminated the FASB's professional independence.¹⁴⁸ In his turn, President Clinton who had campaigned on excessive CEO pay underscored the damage that the FASB rule change would do to the high-tech industry.¹⁴⁹ Under this pressure, the FASB relented and issued its new accounting approach as a nonbinding recommendation. Few if any firms followed it, and the practice of accounting for stock options as though they had no value continued. Interestingly, the Silicon Valley entrepreneurs who played the role of the pandas or whales in the fight to save stock options represent an insignificant proportion of the top 1% and top 0.1%, not significantly more than their predecessors did in 1979.¹⁵⁰ The primary beneficiaries were executives throughout the economy. When the SEC ran a parallel process to the FASB's efforts, seeking to cause public firms to report the value of stock options as part of the compensation of top executives, the same coalition and political process forced the Commission to “compromise” by including in the reporting requirements the number, but not the value, of options granted. This compromise allowed, indeed, encouraged boards to continue to grant the same number of options year after year, even though the rapidly rising market in the 1990s meant that the value of these options was increasing dramatically, in pace with the bubble-driven rise in stock market valuations. The result was that by the second half of the 1990s, CEO compensation became more-or-less perfectly correlated with the S&P 500, which itself reflected the

146<http://www.sechistorical.org/museum/galleries/rca/rca05d-worthless-stock-options.php>

147<https://www.gpo.gov/fdsys/pkg/CREC-1994-05-03/html/CREC-1994-05-03-pt1-PgS34.htm>

148S. 1175, 103d Cong. June 29 1993.

149Murphy 2012 at 80.

150Jon Bakija et al., “Jobs and Income Growth of Top Earners and the Causes of Changing Income Inequality: Evidence from US Tax Return Data,” *Unpublished Manuscript, Williams College*, 2012, <http://piketty.pse.ens.fr/files/Bakijaetal2010.pdf>.

dotcom bubble dynamics, not fundamentals. It was only after the scandals following the burst of the bubble that the rules changed. Enron, Worldcom, and a series of other high profile scandals led to passage of the Sarbanes-Oxley Act and a range of accounting practices changes, including reporting on stock options. In response firms began to adopt the FASB recommended valuation of stock options, and by 2004 FASB adopted its long-deferred accounting change as a requirement for future accounting in fiscal years starting in mid-2005 and accounted for in 2006.

Twenty years after the FASB first proposed this change, which was intellectually and professionally a “no-brainer” (the 1992 rules had been adopted 7-0), the change was finally adopted. But the damage had been done. More than any other component, stock options were the most important vector through which executive compensation grew roughly eightfold during the 1990s. In the decade and a half since, average CEO compensation has indeed continued to vary in tandem with the stock market, but it has never fallen below its late 1990s levels. The new benchmark had been set, and while the vector that raised the baseline level was removed, compensation packages continued to aim at this new benchmark. In form, restricted shares replaced stock options as the preferred mode of compensation once options were no longer accounted as valueless. But these restricted stock did not, in fact, improve the incentives of managers. As Bebchuk and Fried explained, there were a range of options and grants that could have in fact been designed to improve incentives. None of these was adopted by compensation committees. Instead, restricted stock functioned no differently from stock options, except that now they were accounted for, and their strike price was, effectively, zero.

By 2012, after the stock market crash and the shabby tales it told, even the high priests of stock-based compensation were telling a very different story. In their 2012 chapter on performance pay, Jensen and Murphy wrote:

The relations between managers and board members and capital markets are, with few exceptions, characterized by the well-known “earnings management game” in which corporate officers regularly take actions to meet or beat analyst and market expectations for earnings or certain key performance benchmarks. These actions are associated with manipulation, lying, dissembling, withholding of information, etc, and lead to vast out-of-integrity behavior that substantially damages the firm itself and investors, customers, employees, communities and the functioning of the capital markets. The damage caused by this almost universal game is huge.

So here we are. The most influential academics who developed the shareholder value theory and pushed stock options are now arguing that stock-based compensation has destroyed enormous value for most publicly traded firms, and in the process harmed investors, customers, employees and communities (precisely those people who, in their 1990 HBR piece, they derided as “uninvited but influential guests” at the board table). The compensation models developed based on this defunct and failed theory diffused themselves through benchmarking and social status competition to other professionals, throughout the managerial and financial sectors, accounting for something in the neighborhood of 50% to 70% of the increased share that the top 1% and top 0.1% of the income distribution is taking. Given that these members of executive pay and financial industry form the benchmark for other associated professions—like lawyers and consultants—and indirectly, through social benchmarking and wage reference norms to others in their social circles—like doctors or university presidents—this basically destructive practice carries substantial responsibility for most of the explosive extraction at the top 1%.

But even this more complex story leaves out many of the other systems that interacted with the cultural, ideological, and institutional dynamics that drove executive pay. We must now turn to look at income in the financial industry, and how it reflected several additional dynamics that interacted with those we already saw. The great inflation, the monetary response from the Fed that created the high interest rate era, the opening of global capital flows associated with deregulation not only of the US banking system, but of other countries, most importantly Japan, the feedback of the investment of companies into politics and the reorganization of politics on the left all interacted to drive the rise of the 1%.

The political economy of market institutions changes: financialization, the rise of organized business, and the worker-consumer split

It is impossible to understand the rise of the 1% without understanding the dramatic financialization of the U.S. economy after 1980. It played a central role in managerial compensation—through LBOs and stock options—and a central role in financial industry income. It also interacted with the focus of companies on the short term, and the disinvestment from labor that that reorientation wrought. The financial deregulation that was a precondition to financialization began in the 1970s, was itself embedded in a much broader restructuring of American politics around questions of economic organization and the design of institutions that shaped market outcomes.

1. What is financialization and how did it happen?

There have been several historical and political economic treatments of this subject,¹⁵¹ and I will sketch out only the necessary connections that fed into the rise of the 1%. By “financialization” I follow the definition offered by Krippner:¹⁵² the increasing share of financial activities as a source of profits in the economy. This definition therefore includes two quite distinct but related phenomena that characterized the American economy from the 1980s until the Great Recession. The first is the increasing share of total GDP and profits that the financial sector produces. The second is the increasing share of profit that firms in non-financial sectors derived from financial activities. The former is captured by the growing activity and profitability of companies like Citibank or JP Morgan. The latter is captured by the increasing share of profits in companies like General Electric or Sears derived from their financial activities (eg consumer credit to buy their products; or investments by GE Capital), rather than their manufacturing or services activities. Between 1950 and 2001, employment in the financial, insurance, and real-estate sector (FIRE) grew from about 4% of employment to about 7%. During this same period, the FIRE sector doubled its share of GDP from 12% to 24%, and quadrupled its share of corporate profits from about 11% to about 45%. At the same time, the share of portfolio income (interest, dividends, and capital gains) of non-financial firms relative to cash flow (profits plus depreciation) increased from about 7 or 8% throughout the 1950s and 1960s, to about 50% by 2001, and in manufacturing firms in particular, reached nearly 100%. By the end of the 1980s, when interest rates were at their highest, about 80% of nonfinancial firms portfolio income came from interest, while capital gains accounted for 15%; in the latter 1990s, with the stock market boom, interest still accounted for about two-thirds of portfolio income, and about a third was capital gains.

151Greta R. Krippner, *Capitalizing on Crisis: The Political Origins of the Rise of Finance* (Cambridge, Mass: Harvard University Press, 2011); Davis, *Managed by the Markets*; Foroohar, *Makers and Takers*.

152Krippner, *Capitalizing on Crisis*.

Looking at manufacturing, services, and FIRE together, financial activities moved from being less than 10% of the sources of corporate profit to anywhere from 30% to 70%, depending on precise year and different measurement approaches. By any measure, the sectors that were labor intensive – manufacturing and services – accounted for less of overall profit in the economy; and within those labor intensive sectors, the departments that required a substantial labor force – the actual manufacturing or service activities – were contributing a shrinking portion to the bottom lines of companies.

Both aspects of financialization contributed to the explosive growth at the upper end of the income distribution and to the stagnation of median income. At the upper end of the distribution, financialization underwrote the high incomes within the financial industry, based on its high and growing profitability, and provided the mechanism for the explosive growth in CEO and executive compensation, paid in stock options. Both factors, in turn, created benchmarks that ratcheted up the compensation across the industry for social equals, whether or not the particular results of the companies where these social equals worked warranted it. As to middle income wages, financialization led to increasing salience of short run returns in the balance sheets of companies, and to the increasing importance of activities that were disconnected from the core of companies employment-intensive activities. These drew investments to the financial side of non-financial firms, and made short-term cost cutting in these lower-profit manufacturing and services activities an attractive strategy for executives compensated based on short run profitability. This focus on financial returns encouraged disinvestment in longer-term strategies, most importantly employee retention and training, and increased the value of using temporary work or relatively low-skilled workers whose wages could be kept low even if that meant that their marginal productivity was less than optimal, given the declining importance of those parts of the firm that were non-financial to a firm's overall profitability.¹⁵³

Technology played a significant enabling role in financialization. First, a series of theoretical developments in the 1960s and 1970s made laid the foundations of practice. Eugene Fama's work on the efficient markets hypothesis, and more directly Black, Merton, and Scholes on pricing derivatives in particular provided basic theoretical tools available for translation into investment strategies that were far more exotic than had been conceived of before these innovations. Looking at specific innovations practice in the 1960s and 1970s, before these theories took off and before computers were available to implement them, one saw primarily regulatory arbitrage and avoidance innovations. The first major innovation on the practice side was the negotiable certificate of deposit (CD), introduced by National City Bank (now Citicorp).¹⁵⁴ City Bank arranged with a local securities dealer, Discount Corporation of New York, to create a secondary market in these CDs, which therefore became a way for banks to bid for funds in the corporate savings money. All this was in response to limits posed by Regulation Q on what kinds of institutions could lend and take deposits from consumers as opposed to corporations, and at what rates. Not only was this nor theoretically informed, none of the descriptions of these innovations suggest significant technological elements. A 1967 report within the Federal Reserve suggests the importance of local proximity to the relatively large role New York banks played in the negotiable CD market (their proximity to the dealers),¹⁵⁵ and as late as 1980 a paper in the Economic Review explained that "The regional issuers that are most active in the CD market, however, keep a

¹⁵³Davis, *Managed by the Markets*; Foroohar, *Makers and Takers*.

¹⁵⁴Krippner, *Capitalizing on Crisis*, 65.

¹⁵⁵Parker B. Willis, "The Secondary Market for Negotiable Certificates of Deposit" (Federal Reserve System, February 23, 1967), https://fraser.stlouisfed.org/docs/historical/federal%20reserve%20history/discountmech/secmark_willis.pdf.

supply of blank signed certificates in New York so that investors not located in the area and wishing to purchase their CDs can do so conveniently.”¹⁵⁶ Similarly, when money market accounts were first introduced to overcome the absence of an equivalent to savings account in commercial banks (a function of the effort to give thrifts and savings and loans a stable source of revenue to sustain consumer credit), the technologies reported in its use were the telephone and wire transfer that had been in use since early in the twentieth century).¹⁵⁷ Eurodollars, which permitted commercial banks to evade domestic regulations, also required these older technologies.

But the possibility of altering the risk profile of a portfolio, or developing and pricing derivatives became susceptible to translation once personal computers and computerized spreadsheets became available to actually calculate the data necessary to implement the theory. Nonetheless, the introduction of the personal computer and electronic spreadsheet into finance certainly made possible critical changes. Fannie Mae issued the first collateralized mortgage obligation (CMO) in 1983. Without computers, it was too difficult to split large numbers of mortgages into tranches with different prepayment risks. Only with computerized spreadsheets did it become possible to track and calculate the risk associated with large numbers of mortgages, tranches that could then be packaged or sold with different risk-return profiles.¹⁵⁸ Similarly, the flagship LBO firm, KKR, acquired its first Apple II with VisiCalc in 1980, and in 1982 introduced IBM PCs outfitted with Lotus 1-2-3. These seem to have played a substantial role in the firm's ability to plan and present to investors the values of firms to be bought and stripped of their assets.¹⁵⁹ The routinization that Holmstrom and Kaplan suggest played a role in the later 1980s failures is supported by the apparent development, in a matter of a few short years, of \$99 “LBO software packages” advertised in the *Wall Street Journal*.¹⁶⁰ But while the emergence of the PC, coming on the back of theoretical innovations, helped core practices emerge, it was a dramatic change in the institutional framework of credit and finance, itself driven by a politics much more confounding than “greedy Wall Street bought politicians” that created the supply of capital and the context in which the new investment vehicles computation enabled could flourish.

Krippner's account of financialization is anchored in inflation and the social and political responses to it. The basic story is that the Great Inflation led to a need for higher interest rates on bank deposits, first for companies, then for consumers. This pressure to receive higher returns on savings or capital initially led to several innovations in the financial sector, like the negotiable CD, the money market fund, and Eurodollar accounts, that circumvented then-present regulatory limits on the interest available from traditional vehicles. They then translated into pressure, by consumer advocacy organizations, for banking deregulation that would allow regular consumers to obtain higher returns on their savings. As these events were unfolding on the banking and regulatory sides, levels of inflation driven by oil prices finally created the political will for a Fed policy shift that focused on bringing inflation down, even at the expense of a recession and high unemployment. This was the Volcker Shock. To do so, the Fed moved interest rates to levels not seen before, and investment in the US became an extremely attractive investment relative to returns from any other activity. These double

156Bruce I. Summers, “NEGOTIABLE CERTIFICATES OF DEPOSIT,” *Economic Review*, 1980, <http://core.ac.uk/download/pdf/6917570.pdf>. (p. 12).

157Robert D. Hershey, Jr., “Overnight Mutual Funds for Surplus Assets,” *New York Times*, January 7, 1973.

158Leon T. Kendall and Michael J. Fishman, *A Primer on Securitization* (MIT Press, 2000); Cameron L. Cowan, “Hearing on Protecting Homeowners: Preventing Abusive Lending While Preserving Access to Credit,” § Subcommittee on Housing and Community Opportunity (2003), <https://financialservices.house.gov/media/pdf/110503cc.pdf>.

159George Anders, *Merchants of Debt: KKR and the Mortgaging of American Business* (Beard Books, 2002), 39–41.

160George Anders, *Merchants of Debt: KKR and the Mortgaging of American Business* (Beard Books, 2002), 39–41.

digit interest rates prevailing in the 1980s drew investment both out of firms traditionally engaged in non-financial activities, leading to the increasing share of profits attributable to financial activities of non-financial firms, and to an influx of foreign investment into US debt. Both these trends, in turn, led to explosive growth in the financial industry, and to a loosening of fiscal bonds on government policy, as failure to pay for activities became increasingly financed through US debt bought by foreign investors.

After the Depression, the American financial system was highly regulated and segmented. Savings and loans and mutual savings banks (Thrifts) offered consumer deposits and provide mortgage loans, commercial banks offered corporate loans, and investment banks underwrote corporate equity and debt. Regulation Q limited the interest rates that thrifts could pay depositors, while the Banking Act of 1933 prohibited paying interest on demand (checking) accounts. The system restricted access to credit in times of expansion, and created a crude, but effective, counter-cyclical mechanism. When firms were growing and taking loans at market-based rates from commercial banks, money flowed out of savings accounts in consumer banks and into the commercial banks for loans. This, in turn, restricted the availability of funds for mortgages, which brought the housing sector to a halt, and with it restrained the expansion from overheating. When firms cut back investments, the funds flowed back to the consumer bank deposits, which were allowed under Regulation Q to offer slightly higher rates than commercial banks, and these, in turn, were available to offer lower mortgage rates and revive the housing sector. Several of the financial innovations that developed in the 1960s and 1970s—the negotiable CD, the money market fund, and the Eurodollar account (accounts denominated in dollars but held in Europe, and hence outside the regulatory authority of the Federal Reserve)—were all regulatory arbitrage mechanisms, creating unregulated versions of a service that, structured differently, was regulated to restrict credit or its price. When Citibank introduced the first variable rate certificate of deposit aimed at consumers in 1974, an additional factor was added. Citibank had reorganized itself as a holding company, so that the new variable rate certificates could be issued at higher rates than those permitted by Regulation Q. Contrary to consumers' assumptions, however, this also meant that these variable rate instruments were not longer federally insured deposits.¹⁶¹

The combination of public finance commitments created by the Vietnam War and the War on Poverty required both Democratic and Republican administrations to either choose among competing uses of limited funds, or to live with inflationary pressures. In 1971, Richard Nixon attempted to stop the dynamic by announcing that the United States would no longer maintain convertibility of the dollar into gold, a move that would ultimately lead to abandonment of the Bretton Woods system and the role of the U.S. dollar as the reserve currency of the world; and imposed wage and price controls. Inflation nonetheless doubled from 1965 to 1973.¹⁶² The money market and Eurodollar markets, as well as expansion of the negotiable CD market, expanded the range of options for higher interest rates, but were available only in relatively large denominations to corporate customers, not to consumers. Banks

161Greta R. Krippner, *Capitalizing on Crisis: The Political Origins of the Rise of Finance* (Cambridge, Mass: Harvard University Press, 2011).

162J. Bradford De Long, "America's Only Peacetime Inflation: The 1970s," accessed August 5, 2015, http://delong.typepad.com/peacetime_inflation.pdf; Romer, Chsitina, "Commentary: In Defense of the Ideas Hypothesis," *Federal Reserve Bank of St. Louis Review*, no. March April Part 2 2005 (2005), <https://research.stlouisfed.org/publications/review/05/03/part2/Romer.pdf>. These papers focus on these causes for inflation, rather than the later spikes due to oil prices. My point, later, that oil was central, is focused primarily on the shift in the political acceptability of the Volcker shock, where I think it hard to argue that the oil shocks of 1973 and 1979 played a substantial role because of the magnitude of the inflation spikes associated with these discrete events.

now had avenues to avoid the restraining effects of Regulation Q, because they could obtain funds to fund commercial loans not from regulated sources but from unregulated sources like the Eurodollar market. If in expectation of rising prices consumers would go up and buy more sooner, the older system of credit rationing would have dried up consumer credit and removed that component of overheating the economy. But when commercial banks found new sources of credit, savings banks and credit unions could continue offering consumer credit and mortgages, and the inflationary expectations fed into additional consumer demand that could still access credit. Beginning in the early 1970s several efforts to deregulate interest rates sought to introduce price discipline instead of regulation. The thought was that if interest rates were allowed to rise without regulatory caps, the rising price of money would operate to restrict access to credit and to slow down an overheated economy.

The oil embargo and spike in the price of oil in late 1973 took the already unprecedented inflation rate to new heights, ushering in the era of double-digit inflation and created a new politics of bank regulation.¹⁶³ In particular, the consumer depositors became a major force in favor of deregulation, because they were seeing their savings erode through inflation while their accounts were offering regulated rates of return that could not keep up with inflation. “Consumers Union, Consumers Federation of America, and Ralph Nader's Public Citizen had begun to actively campaign for the repeal of Regulation Q.”¹⁶⁴ These were joined by the AARP and other retiree organizations concerned about erosion of their savings. These pressures, crystallized in President Jimmy Carter's address to Congress urging them to deregulate consumer credit and depository institutions lending practices, together with bargains struck between the thrifts and the commercial banks about how the regulations could be removed in a way that would benefit them all, culminated in the passage of the first major deregulation act in the spring of 1980, several months after the Iranian Revolution created the second oil-shock-induced inflation spike and before the election of Ronald Reagan. The politics of bank deregulation in the 1970s suggest a much more interesting dynamic than simpler “neoliberalism did it” narratives.

2. *Political Dynamics of the Great Inflation: Neoliberalism, Organized Business, and the Consumer-Worker conflict over deregulation*

The political shock that was the Great Inflation allowed three distinct political and ideological trends to converge on deregulation of banking, international financial flows, and retirement savings. Together these created a supply shock of investment-seeking capital, and a new and unfamiliar environment where new players, previously working within quite tight constraints both nationally and internationally, were able to take advantage of the new available investment capital, wielded by organizations that had not historically engaged in stock markets or exotic instruments, and leverage them to a rapidly rising debt and stock markets. These three trends were the validation of Friedman's monetarism and with it the very basic neoliberal case for deregulation across the board, including finance; the rise of organized business as a political force; and the split within the left between the consumer movement and the unions, which contributed to the declining power of labor.

a. Neoliberalism establishes primacy

163Alan S. Blinder and Jeremy B. Rudd, “The Supply-Shock Explanation of the Great Stagflation Revisited” (CEPS Working Paper No. 176, November 2008), <https://www.princeton.edu/ceps/workingpapers/176blinder.pdf>; Ball, Laurence and Mankiw, Gregory N., “Relative Price Changes as Aggregate Supply Shocks,” *Quarterly Journal of Economics* 110, no. 1 (February 1995): 161–93.

164Krippner, *Capitalizing on Crisis*, 76.

First, Milton Friedman's technical work on monetarism became the most direct source of legitimacy for neoliberalism as a policy program, as well as its most direct tie to the policies of oligarchic extraction. Beginning after the Great Depression and ending with the Great Inflation, the dominant theory of how the state operates to stabilize the economy was built on the work of John Maynard Keynes. Specifically in the case of depression and unemployment, the role of the state was to use fiscal policy (spending and taxing) to make up for shortfalls in aggregate demand during periods when households and business were cutting down on expenditures. Monetary policy—determining how much actual printed money is out there and influencing how much money is in bank deposits by influencing the interest rates—was secondary. Friedman long championed the idea that the primary role of the state was through assuring stable monetary growth, and that as long as this was done, all actors in the economy would adapt their expectations and behavior to that policy and lead fluctuations of growth and recession to be moderate. In a famous co-authored book, *A Monetary History of the United States, 1867–1960*, written with Anna Schwartz, Friedman argued the case that the Great Depression was the result of a fall in the money supply, not in aggregate demand, and therefore could have been avoided if the Federal Reserve had stepped in and lent them the funds to avoid collapse. In an even more famous presidential address at the American Economics Association, took this basic claim that the Fed could have done more to support failing banks, and implied that the Fed had actually caused the Depression by failing to do its job.

The argument about the Depression fed directly into Friedman's more general skepticism of government management of the economy, but specifically claimed to support his argument that stabilizing the growth in money supply was the core function in the economy, rather than fine tuning aggregate demand. At that same 1967 presidential address, Friedman argued that the supposed tradeoff between inflation and unemployment was false, because both workers and businesses would adjust their expectations to rising inflation. Instead of inflation raising prices, which increases investment and increases employment, workers would expect inflation to continue and demand higher wages, employers would anticipate these higher wage demands and avoid responding to rising prices with rising output, and we would see higher inflation and high unemployment coincide. This prediction, made at the very beginning of the inflationary period of 1966-1979, was seen as prescient when inflation in fact grew and unemployment persisted in the condition then dubbed “stagflation.” Friedman's reputation as an economist became unassailable, and in 1979, when Paul Volcker took over as Fed chairman, Friedman monetarism became the formal policy of the Federal Reserve. Within a short number of years the experiment failed, and while the “Volcker shock” did bring about the end of inflation, the recession that followed proved politically unsustainable, and since then, in fits and starts described by Krippner in detail, the Fed moved to a policy of fine tuning the money supply precisely to balance the tradeoff between unemployment and inflation that Friedman claimed did not exist. But the experience of the 1970s and the intellectual framework that Friedman developed continued to anchor the Fed's policy in preventing inflation. Mishel et al have argued that this policy of focusing on inflation prevention alone, rather than the balance of unemployment and inflation, led to excessive unemployment—unemployment above the level that could have been consistent with stable and manageable inflation—and this was, in turn, the primary driver of stagnating male wages at the lower end, and an important contributor to stagnant wages in the middle of the income distribution as well.¹⁶⁵

At a much more fundamental level, Friedman's work on inflation and unemployment reflected the application of rational actor theory at an individual level, including rational expectations as one

165Mishel, Schmitt, and Shierholz, “Wage Inequality.”

subset was later called, to areas of economy and society previously thought of only on macro-scales. The reason inflation and unemployment were not traded off in Friedman's theory was that individual workers and employers adjusted their behavior rationally and with rational expectations, thus foiling the intended impact of the intervention. Robert Lucas formalized this treatment of macro-scale economic phenomena as aggregations of microeconomic decisions in the 1970s.¹⁶⁶ It was this basic understanding of human systems—as outcomes of individual behaviors that can be fully explained within the framework of *homo economicus*—that was the big foundational insight. George Stigler introduced the idea of “regulatory capture” based on it. James Buchanan and Gordon Tullock launched public choice theory in *The Calculus of Consent* in 1962. Others, before and after, included Anthony Downs's *Economic Theory of Democracy* and Mancur Olson's *The Logic of Collective Action*, all contributed to the development of the basic belief that public institutions could not work. Individual self interest—of the legislators, regulators, or regulated industries—would drive differential investments in pursuing self-interested goals, and all these would result in regulation being captured by the regulated industries or laws being passed to gain advantage over competitors. Unlike Hayek's original point about complexity and information being the limits on planning, it was the fact that people could be relied on to act with self interest and guile, as game theory came to put it, that got in the way of effective government management of the economy. Only well-structured incentives in markets could assure desirable outcomes. Public action failed repeatedly and predictably because human nature (or at least the best-functioning model we have of human nature) made it so. It was this set of ideas that drove the re-imagining of management towards shareholder value and the emphasis of agency theory on stock-based compensation that sent executive compensation into escape velocity, as we saw above. But it was also this set of ideas that underlay the basic commitment to deregulation and free markets that found one major manifestation in the deregulation of the financial sector.

b. The Rise of Organized Business

The disruption of the Great Inflation also offered an opportunity for changes in the political strategy of the business community. Several scholars have, over the years, documented the concerted efforts of the business community to build economic power since the 1970s. David Vogel early described the sense of crisis that businesses experienced in the late 1960s, having lost a series of political battles, and the sustained organization of business political clout following that moment.¹⁶⁷ Kim Phelps-Fein documented the dramatic growth over the single decade of the 1970s in the number of companies that had public affairs offices in Washington D.C (grew five fold), had registered lobbyists (more than tenfold, from 175 to 2,445 companies), or the number of corporate PACs (quadrupled).¹⁶⁸ Hacker and Pierson's *Winner-Take-All Politics* builds on these insights to make the broader case: that this shift in business strategy to capture political power is the direct cause of rising inequality in the past forty years.¹⁶⁹ They begin by quoting Vogel's argument that the first years of the Nixon administration, 1969-1972, as the time when “virtually the entire American business community

166Robert E Lucas, “Expectations and the Neutrality of Money,” *Journal of Economic Theory* 4, no. 2 (April 1972): 103–24, doi:10.1016/0022-0531(72)90142-1; Robert E. Lucas, “Econometric Policy Evaluation: A Critique,” *Carnegie-Rochester Conference Series on Public Policy* 1 (January 1976): 19–46, doi:10.1016/S0167-2231(76)80003-6.

167David Vogel, *Fluctuating Fortunes: The Political Power of Business in America* (New York: Basic Books, 1989)

168Kim Phelps-Fein, *Invisible Hands: The Making of the Conservative Movement from the New Deal to Reagan* (New York: Norton, 2009)

169J. S. Hacker and P. Pierson, “Winner-Take-All Politics: Public Policy, Political Organization, and the Precipitous Rise of Top Incomes in the United States,” *Politics & Society* 38, no. 2 (June 1, 2010): 152–204, doi:10.1177/0032329210365042; Hacker and Pierson, *Winner-Take-All Politics*, 2010.

experienced a series of political setbacks without parallel in the postwar period.” The rise of the environmental movement in the 1960s, catalyzed by Rachel Carson's *Silent Spring* in 1962 and culminating in the creation of the Environmental Protection Agency in 1970; the rise of the consumer movement, personified by Ralph Nader, his attack on the automobile industry's safety standards in *Unsafe at Any Speed* and subsequent battle with GM, and the creation of the Nader Raiders, a program which saw hundreds of law school students working to study the ways in which government agencies, beginning with the Federal Trade Commission, were failing to do their jobs and stand up to business interests. These studies exposed a cozy relationship, often on the wrong side of the line to corrupt, that fundamentally disabled regulatory effectiveness. A string of losses in environmental regulation, consumer protection, and occupational safety triggered a response within the business community aimed at shoring up, and strengthening, their political power. The shift is now widely attributed to the *Powell Memorandum*, a memorandum carrying the Red Scare inspired name of: *Attack on the American Free Enterprise System*. In it Powell outlined a broad strategy, from investment in political power, which is Hacker and Pierson's core concern, to investment in capturing ground in practically every dimensions of power I have outlined here except technology: battling academic appointments based on political view point, capturing media, investing in activist litigation to expand corporate rights by judicial interpretation, mobilizing shareholders, and taking on a generally more aggressive attitude across the board to roll back the political achievements of unions. “There should be no hesitation to attack the Naders, the Marcuses (referring to Herbert Marcuse) and others who openly seek destruction of the system. There should not be the slightest hesitation to press vigorously in all political arenas for support of the enterprise system. Nor should there be reluctance to penalize politically those who oppose it”¹⁷⁰ wrote Powell.

The strategic redeployment of business power into political power moved along three trajectories. First, internally, companies began to invest in becoming more adept at political intervention. The nearly fifteenfold increase in the number of companies who had a registered lobbyist on pay over the course of the 1970s is as strong an indicator as any of this basic shift. Second, firms improved their collective action mechanisms. In 1972, the National Association of Manufacturers moved their main office from New York to D.C., specifically citing as a reason that relations between business and government had become more important to their role than relations among businesses. Coordinating membership organizations like the U.S. Chamber of Commerce and the National Federation of Independent Businesses doubled their membership over the decade. Between 1972 and 1978, the Business Roundtable grew from a conversation of three big companies to include 113 of the Fortune 200 companies. Third, businesses developed a grassroots/grasstops strategy, combining small businesses that harnessed their employees and local members to talk to individual legislators, while larger organizations learned how to mobilize employees and shareholders to write to Congress as individual constituents. At the top, inside game, the coordinating networks of businesses learned how to reach out to each others contacts and deploy CEOs and state and local business leaders to reach out directly to legislators or executive branch officials.

The shift in power, and the ways in which it tied in directly to the rise in inequality are evident, in Hacker and Pierson's account, two major legislative defeats suffered by the post-Watergate Democratic majority marked the overwhelming new power of business. After Watergate, the 1976 election brought not only Jimmy Carter to power, but provided the Democrats with substantial majorities in both Houses of Congress. Both consumer and labor power was tested, and both came up

170 Lewis Powell, *Attack of American Free Enterprise System*. Memorandum to Eugene B. Snyder, Jr. Aug. 23, 1971.

short. Democrats tried to create a new Office of Consumer Representation. The Business Roundtable coordinated an attack in media outlets, letter writing campaigns, and individual pressure on marginal members that successfully blocked this then-highly-popular consumer protection reform. Labor tried to re-introduce a bill already passed before the election by both houses and vetoed by President Ford, but failed, and then organized a major campaign to reform the way the National Labor Relations Board worked, speed up decision-making and increase fines for violations. Again, a major campaign on both sides ensued, and again, using the veto points in the Senate and a major multi-dimensional campaign the Business Roundtable coordinated a victory. If at the beginning of the 1970s business seemed to be losing political ground, by 1978 these victories marked a new order. Organized labor was unable to overcome organized business even with a Democrat in the White House and Democratic majorities in both houses.

The Organized Business aspect of the politics of oligarchy is not the whole story, but it is a whole lot of the story. It doesn't account for the fact that the institutions of the state are too imperfect, too bounded in the degree to which they influence society to tell the whole of the story. It, doesn't, for example, explain the much more muddled origins of financialization or the rise of shareholder value theory and stock-based CEO compensation, which the Business Roundtable opposed until well into the late 1990s¹⁷¹—though it does explain some of why no political regulatory response was possible to reverse or moderate these trends or their effects on ultimate income inequality. It doesn't explain the broad ideological shift that undergirded organizational and normative changes. It doesn't explain why the left retreated from the economic equality battlefield and moved on to civil rights, gender, and environmental politics. It is too American in its telling here. Nothing equivalent to the emergence of organized business in Britain that accounts for the rise of Thatcherism in the ways in which Hacker and Pierson's story so convincingly argues was the case in the rise of Reaganism.¹⁷² Rather, the professionalization and organization of business lobbying in the UK came largely as a response to the entry of multinationals and the disembedding of British finance and business from the social networks of the governing elite after, and as a result of, the liberalization forced through by Thatcher and the increasing importance of Brussels.¹⁷³ Britain did, however, share a transatlantic shift toward neoliberal ideology and norms.

c. The Consumer and Labor Movements Divided

The main empirical limitation of understanding the shift in political power as one that marks the rise of Organized Business is that it does not explain the major deregulation moments of the 1970s: airline, trucking, telecommunications, and most importantly in the long term for the top 1%, banking and finance. In each of these, particularly banking and airlines, much if not most of the impetus for deregulation came from consumer advocates. In the cases of airlines, trucking, and telecommunications it came over the fierce opposition of major incumbent companies in close cooperation with major unions. AT&T and the Communications Workers of America were opposed to deregulation, as were the major trucking companies working hand in hand with the Teamsters. It was Senator Edward

171Holmstrom and Kaplan, "Corporate Governance and Merger Activity in the US."

172Stephen Wilks, *The Political Power of the Business Corporation* (Cheltenham, UK: Edward Elgar, 2013), 106 citing Grant W., and D. Marsh, 1977 *The Confederation of British Industry*. London: Hodder and Stoughton 213.

173Michael Moran, "The Company of Strangers: Defending the Power of Business in Britain, 1975–2005," *New Political Economy* 11, no. 4 (December 2006): 453–77, doi:10.1080/13563460600988545; Michael Moran, *Business, Politics, and Society: An Anglo-American Comparison* (Oxford ; New York: Oxford University Press, 2009).

Kennedy who chaired the Senate committee study that drove airline deregulation and blazed the path for the other deregulatory moves, and Jimmy Carter under whose presidency the major legislative and regulatory decisions pushing deregulation of these industries occurred. Both were driven primarily by a consumer protection rationale. It was Ralph Nader, Consumers Union, the Consumers Federation of America, and the AARP who pushed banking deregulation in the 1970s in the name of consumer savers, not the Business Roundtable. Strong unions get high wages, and regulation-limited competition allows firms to raise prices and share the rents with these strong unions. The Teamsters were right to oppose deregulation: two years after passage of the Motor Carrier Act of 1980, the Teamsters Union agreed to a long term contract that raised total compensation at half the rate of inflation and Teamsters locals representing drivers in the smaller carriers that proliferated after deregulation were accepting wage cuts of 10-15%; while the Airline Pilots Association accepted wage deferrals or freezes over forty times between 1980 and 1984.¹⁷⁴ A series of studies in the late 1980s through the 1990s found that unionized male workers with good earnings in regulated industries lost significantly from deregulation. Truckers in particular were affected,¹⁷⁵ but deregulation contributed more to increased inequality in wages for male union workers, in particular those who earned relatively well among workers, than it did for other groups, while other factors like minimum wage and deunionization itself were more important to other segments of the working population.¹⁷⁶

For our purposes here, though, what is important about the flourishing of deregulation between 1975 and 1980 is that it discloses fissures in the left that were likely as foundational to the political economy of the next forty years as was the creation of Organized Business. The rising power of the consumer movement, and the distrust in government agencies captured by big business that it shared with the neoliberals, meant that those parts of the left still focused on the economy were split between pro-consumer and pro-worker arms. If business was pushing against regulation and redistribution in some domains, consumers followed up on the victories in the early 1970s with further pulling toward deregulation. It is impossible to understand the runaway power of finance, and the central role of financialization in driving inequality, without recognizing the central role that the consumer movement played in fighting for financial deregulation in the 1970s. It is a mistake to try to understand the thirty years of deregulation and skepticism about the effectiveness of government agencies without recognizing the central role that protecting consumers from what was perceived as a business-dominated regulatory culture played.

Unintended consequences were central to understanding that past, but recognizing and responding to the fundamental tension between the masses of the population in their role as “consumers” and in their role as “workers” will remain with us forever as we try to design a future that is indeed more egalitarian. It is as present in the tension between Uber users and Uber drivers as it was between telephone subscribers or airline passengers and the CWA or the pilot unions; between consumers happy to buy high quality inexpensive products imported from developing countries and the worker advocates who point out the job and wage losses that accompany free trade. For now, as I try to unpack the role of political power and how it shifted in the 1980s, looking at the stories of banking and

174Martha Derthick and Paul J. Quirk, *The Politics of Deregulation* (Washington, D.C: Brookings Institution, 1985), 3.

175Barry T. Hirsch, “Trucking Regulation, Unionization, and Labor Earnings: 1973-85,” *The Journal of Human Resources* 23, no. 3 (1988): 296, doi:10.2307/145831.; Hendricks, Wallace, “Deregulation and Labor Earnings,” *Journal of Labor Research*, Summer 1994, 15, 207–34; Rose, Nancy L., “Labor Rent and Regulation: Evidence from the Trucking Industry,” *Journal of Political Economy*, December 1987, 95, 1146–78.

176Nicole M. Fortin and Thomas Lemieux, “Institutional Changes and Rising Wage Inequality: Is There a Linkage?,” *The Journal of Economic Perspectives* 11, no. 2 (1997): 75–96.

airline deregulation exposes the basic dynamic that the consumer/worker split introduced in airline, trucking, and telecommunications, and its parallel in the dynamic of the consumer saver vs. the consumer borrower in banking and finance.

On February 6th, 1975, following six months of preparation, Senator Edward Kennedy opened a series of hearings of the Subcommittee on Administrative Practice and Procedure of the Senate Judiciary Committee.

Federal regulation of transportation began in the 1880's with two objectives: First, to protect the consumer from concentrations of economic power, and second, to guarantee that essential transportation would be available to all Americans. But regulation has gone astray. What may have been good for the last quarter of the 19th century is a disaster for the last quarter of the 20th century. Either because they have become captives of regulated industries or captains of outmoded administrative agencies, regulators all too often encourage or approve unreasonably high prices, inadequate service, and anticompetitive behavior. The cost of this regulation is always passed on to the consumer. And that cost is astronomical.

...

President Ford is asking the American people to absorb billions of dollars in additional living costs to alleviate our energy problems. At the same time, he is asking Congress to freeze or reduce spending on social programs designed to ease the financial burden on those least able to cope with recession and inflation. The President is predicting a frightening unemployment rate of over 8 percent to continue during the next several years.

Americans are being asked to make these harsh and difficult sacrifices. Many of these sacrifices cannot be justified on their own; but they stand in even starker contrast with the continuing drain on our economy that regulatory agencies impose.

The direct effects of regulation by the Civil Aeronautics Board are translated into the prices the public pays to get from one city to another — whether for business, pleasure, or family emergencies. Some critics have estimated that as a direct result of CAB regulation the public pays from 32 to 47 percent in excess air fares. These inflated costs are passed on to the consumer by the sellers of goods and services who must utilize the airplane to transport its products and employees. CAB economic regulation is thus of vital concern to every American. Although the way the CAB regulates may be complex, the effects of that regulation are dramatic and clear.

In these opening paragraphs, all the core elements of the left-of-center support for deregulation are laid out crisply. Regulatory capture of regulators by industry leads to high costs that are passed on to the consumer. High inflation coupled with high unemployment is creating a crisis that is putting stress on the most vulnerable populations, and in the midst of this crisis Americans are being asked to pay ever higher prices to sustain high profits for regulated prices. The terminology “These inflated costs” linguistically ties the overpriced flights to the scourge of inflation that is high on everyone's minds at the time, and these are passed on to *consumers*, who are here the object of public interest concern. The basic logic of these paragraph describes the basic dynamic on the left that complemented and reinforced the business drive on the right. The neoliberal version of regulatory capture anchored specifically in George Stigler's work as well as more broadly in the development of Public Choice theory in the Virginia School dovetailed well with the deep skepticism and exposes of the Nader Raiders and the consumer movement. Combining meticulous research, crusading popular style, and

Ivy League legitimization, and congruent with a deep disaffection with institutions that typified the New Left more generally, reports with names like *The Interstate Commerce Omission*,¹⁷⁷ which excoriated the ICC, charged with trucking and railroad, contributed to a left version of deregulation that refocused egalitarian politics away from the unionized workers of these regulated industries and toward the consumers of these high-rent businesses and the corruption of the business-government relationship these prices reflected. In his written testimony to Kennedy's hearings, Nader argued for abolishing the Civil Aviation Board altogether, painting it as a good place to start to respond to “arrogant and unresponsive bureaucracies serving no public purpose.”¹⁷⁸ Guided by the skillful hands of Stephen Breyer, special counsel to the subcommittee, Kennedy's right hand (if not guiding hand) in these hearings, and later Supreme Court Justice, the committee emphasized the consumer aspect. One day was dedicated to stories of lost luggage and dogs frozen when carried as freight, underscoring the fact that the committee staff had disclosed that the CAB spent only 3 percent of its time on consumer complaints and over 60 percent of its time on beating down charter airlines that had the temerity of offering lower rates.¹⁷⁹

In the half decade that followed Kennedy's initial hearings, deregulation became a widely accepted fashion. Enjoying the support of business in some major industries like finance and securities regulation, as well as in areas where there was major divergence with the left like occupational health and safety or the environment; anchored in an academic and theoretical traditions that had both right (public choice; regulatory capture) and left (crony capitalism, big business big government nexus) origins, and endorsed by both Republicans and Democrats at least in some domains, deregulation became something all reasonable people should agree on. It represented a set of achievable policy successes whose left object of concern was the consumer; it offered victories in an area that everyone was worried about in the midst of high inflation—prices; and showed that government could do something in the face of broad loss of confidence in government's ability to manage the economy.

Let me emphasize to respond to the obvious misunderstanding of this section. I am not saying that Ralph Nader, or Ted Kennedy, or Stephen Breyer are responsible for a generation of rising inequality in America. I am not saying that the story of regulatory capture is pure bunk, and that there is no such thing as industry capturing regulators to extract rents. And I am not saying that the consumer movement undermines the interests of working families. I am saying that as we consider what happened to political power in the 1970s, a critical dynamic was that those parts of the left that were concerned with economic outcomes and welfare and government intervention in the economy split between those whose focus was dominated by concerns for consumers and prices, and those who focused on working families and their income significantly weakened the political resistance of the left to the emerging power of organized business. The shape of political coalitions is a critical determining factor in the shape of economic organization in any society. Any future movement or intervention will have to account for the competing effects of higher wages and higher prices. Reembedding markets in social relations will require a more expansive view of what matters in the economy. We already see it in ethical consumption movements—whether ethics in buying organic, or local, or fair trade. But we also see the difference between those more consumer-oriented and environmental writers who celebrate collaborative consumption as a panacea, and those who are concerned that the fragmented workforce delivering these “sharing economy” services is getting an ever more precarious and miserable return to

177Robert Felmmeth, *The interstate commerce omission, the public interest and the ICC;: The Ralph Nader study group report on the Interstate Commerce Commission and transportation* (Grossman Publishers 1970).

178Derthick and Quirk, *The Politics of Deregulation*, 51.

179Ibid., 44.

work. The tension between policies that singularly focus on the many as consumers and those that focus on them singularly as the workers is not one we can simply ignore as we design an alternative to oligarchic capitalism.

3. *Foreign capital flows create a supply shock, financing the debt-fueled M&A and LBO takeoff*

In January 1979 the Shah of Iran left the country amidst the revolution that would soon result in the creation of the Islamic Republic. Over the next year, the price of oil doubled,¹⁸⁰ and with it inflation reached its highest peak in a decade that had already seen higher peacetime inflation than the United States had ever experienced (the prior peak had followed the 1973 oil embargo).¹⁸¹ A half decade of stagflation had changed the political winds, and provided the foundation for the Volcker Shock of 1979-1982: a new Fed chair, with a new monetarist policy, who promised and delivered high enough interest rates to induce a recession and bring inflation to heel.¹⁸² At the same time, Japan, similarly affected by inflation and high oil prices, saw its growth rate cut in half and domestic investment opportunities slow. Partly in response, Japan deregulated its own financial markets, in particular with relation to foreign capital flows.¹⁸³ In 1980, the government radically changed its Foreign Exchange and Foreign Trade Control Law. The law had originally prohibited most foreign capital outflows to prevent capital flight after the war, but in 1980 this restriction was mostly lifted, allowing Japanese firms to seek higher interest rates and returns than available in the now more saturated Japanese market.¹⁸⁴ A contemporaneous UPI report suggests that half of Japanese firms surveyed were planning to use this reform to buy US assets in response to the high US interest rates.¹⁸⁵

In the first half of the 1980s, these investments were primarily portfolio investments. Some went to finance the new sustained deficits that resulted from the Reagan Administration tax cuts and military expansion by providing a new, and hitherto unanticipated market buyer for US government debt. The new foreign investments fundamentally changed the politics of deficits, and, while initially unanticipated, by 1984 the US Treasury had reoriented its debt instruments to make them even more attractive to Japanese and European investors.¹⁸⁶ Some went into corporate debt, and by 1986 about 40% of the total market value of US non-financial corporate debt—the very source of funding for the LBO and debt-funded M&A markets—was held by foreign investors.¹⁸⁷ While some American firms and politics tended to see Japanese foreign investment as threatening, the Administration continued to pressure Japan to further liberalize its markets, resulting in increased capital flows into the U.S. In the

180Crude Oil Prices: 70 Year Historical Chart. <http://www.macrotrends.net/1369/crude-oil-price-history-chart>.

181Alan S. Blinder and Jeremy B. Rudd, “The Supply-Shock Explanation of the Great Stagflation Revisited” (CEPS Working Paper No. 176, November 2008), <https://www.princeton.edu/ceps/workingpapers/176blinder.pdf>; J. Bradford De Long, “America’s Only Peacetime Inflation: The 1970s,” accessed August 5, 2015, http://delong.typepad.com/peacetime_inflation.pdf; Romer, Chsitina, “Commentary: In Defense of the Ideas Hypothesis,” *Federal Reserve Bank of St. Louis Review*, no. March April Part 2 2005 (2005), <https://research.stlouisfed.org/publications/review/05/03/part2/Romer.pdf>.

182Krippner, *Capitalizing on Crisis*.

183Ibid.

184Kenusuke Hotta, “Deregulation of the Japanese Financial Markets and the Role of Japanese Banks” February 2, 1992, https://academiccommons.columbia.edu/download/fedora_content/download/ac:123029/CONTENT/OP_07.pdf.

185“Japan Introduced a Series of Foreign Exchange Law Amendments...,” *UPI*, accessed January 10, 2017, <http://www.upi.com/Archives/1980/12/01/Japan-introduced-a-series-of-foreign-exchange-law-amendments/3222344494800/>.

186Krippner, *Capitalizing on Crisis*, 92–101.

187“Quarterly Update: Foreign Ownership of U.S. Assets - Council on Foreign Relations,” accessed January 9, 2017, <http://www.cfr.org/united-states/quarterly-update-foreign-ownership-us-assets/p25685>.

latter 1980s, this portfolio investment migrated to direct investment, in stock and assets as well, including not only manufacturing but also financial industry firms.¹⁸⁸ This major supply shock of investment capital was complemented to some extent by deregulation of retirement system investment option in the United States. Again, driven by the need to respond to the erosion of retirement savings, pension plans, including public pension plans like the California Public Employee Retirement System (CalPERS), were partly deregulated and began to invest in higher-risk, higher-return investment outlets. These, in turn, became the core of a new class of “institutional investors” who provided a major new source of investment capital in the M&A market.

The high interest rates that drew these new sources of capital also meant that corporate borrowing rates were high. These, in turn, drove operating non-financial firms to seek only investments whose return was high enough to cover these high costs—and that turned out to be more often financial portfolio investment than expanded activities in the real economy—the very mark of financialization.¹⁸⁹ Profits in nonfinancial firms came increasingly from their financial arms, while profits in the economy in general tended to shift from non-financial to financial firms.¹⁹⁰ Inflation had in effect shifted from the real economy to the price of financial assets, only it was not called so. The financialization dynamic, in turn, drove the dramatic bubble-driven rise in the stock market over the next quarter century, and with it the rising salaries in the other major component of the top 1%, financial industry employees. It also put pressures on short-term vs. long-term investment in firms, providing some of the impetus for casualization of labor and the emphasis on labor cost containment, which played a major role in the stagnation of middle-class wages.¹⁹¹

The supply shock of new sources of capital, arising from political responses to inflation, deregulation, and globalization of capital markets, and the new expectation of new and unprecedented levels of return in an unusually high interest environment, opened the door to new forms of finance. The combination of new sources of investment funds, new expectations for returns on the background of unusually high interest rates, deregulation of financial institutions, and technological tools that made it possible to create new and exotic instruments whose magical new return properties could be tied to their newness and the newly deregulated environment provided enough of a staging ground for the takeoff of the financial markets, and with them the market-tied compensation of the core of the top 1%. The most extensive study of financial industry compensation found quite clearly that the relative wage and the relative education of employees in the financial sector shifted dramatically around 1980,¹⁹² that highly-educated workers in finance outpaced other highly-educated workers, like engineers,¹⁹³ and that financial industry executives outpaced their colleagues outside of the financial industry.¹⁹⁴ They also found that most of this effect was due to introduction of complex financial products outside of the normal credit and insurance service markets, and that financial deregulation was a much more important driver of this increase in relative wages in the sector than IT or software.¹⁹⁵ Unsurprisingly,

188Edward Graham M. and Paul Krugman, in *Foreign Direct Investment*, A National Bureau of Economic Research Project Report (Chicago: University of Chicago Press, 1993), 13–36.

189Krippner, *Capitalizing on Crisis*.

190Ibid., 30–40.

191Davis, *Managed by the Markets*.

192T. Philippon and A. Reshef, “Wages and Human Capital in the U.S. Finance Industry: 1909-2006,” *The Quarterly Journal of Economics* 127, no. 4 (November 1, 2012): fig. 1, doi:10.1093/qje/qjs030.

193Ibid., fig. XI.

194Ibid., fig. III.

195Ibid., 1586.

these returns drew a high proportion of college graduates who might otherwise have gone into other disciplines into finance, causing what some have lamented as a misallocation of highly-skilled labor away from more productive activities.¹⁹⁶

Had all this increase in returns to financial industry workers resulted in higher productivity growth or greater stability in markets, it might be dismissed as a worthwhile price. It did not. Productivity growth throughout the period of financialization was lower than its rates in the preceding nine decades. Worse, it introduced volatility and insecurity in financial markets that has repeatedly plunged market societies under oligarchic capitalism into periodic paroxysms. After several decades of stable markets between the end of WWII and the 1980s, the deregulated finance era saw the savings and loan crisis in the late 1980s, the Asian financial markets crash in 1997, the dotcom bubble and its collapse in 2000-2001, and finally the mortgage-backed-securities calamity in 2008 that resulted in the Great Recession. This latter meltdown is most directly and intuitively linked to excessive complexity in financial products of precisely the form that was introduced in the 1980s and allowed financial industry players to maximize their rent extraction relative to other sectors.

¹⁹⁶Goldin, C. and L. F. Katz (2008, May). Transitions: Career and Family Life Cycles of the Educational Elite. *American Economic Review: Papers and Proceedings* 98 (2), 363-369.

Conclusion: What's Left?

The rise of the 1% was not a single system event, but the result of a multiple-system interaction. It was not technologically driven, though technology played a critical role in enabling implementation, and amplifying some of these effects. It was not driven by a right wing conspiracy of elite businesses, although business lobbying played an important role at critical junctures. It certainly depended on the intellectual ascendance of neoliberalism, but it also emerged from left wing skepticism about regulation and consumer-oriented drives for deregulation. Changes in popular culture that tied social status to money more directly than had typified the prior three decades, particularly perceptions of superstars, their importance, and the legitimate levels of compensation they could expect, played a critical role. The dynamic reflected both intended and unintended consequences. And whatever else it may have been, it introduced dynamics that reduced productivity growth, rather than enhancing it, in ways that appear to have overridden whatever productivity-enhancing characteristics digital technology made possible. The story is not one of skills and technology leading to winner-take-all markets that lifts all boats as long as we have enough redistribution. It is a story of power and rent extraction by those who were in the position to take advantage of broad social and intellectual dynamics, political shifts, and organizational transformations to capture the overwhelming majority of the gains from market production.

The stagnation of median income follows similar patterns and is causally linked to the extraction dynamics of oligarchic capitalism, although a more detailed analysis will have to await later work. The most widely accepted explanation of middle-class stagnation, skills-biased technical change in both its canonical and tasks framework, became untenable as wage patterns changed from decade to decade and country to country in ways that required repeated restatement of the theory. Like the top 1%, the story of income stagnation is primarily a story of power over the distribution of rents, rather than technology-induced or other changes in productivity. The decline of unions played a central role, as Richard Freeman already observed in 1980, and others have continued to document since.¹⁹⁷ Inflationary erosion of minimum wages coupled with political resistance to keeping minimum wages at more or less steady real wages contributed to both lower quintile and median income stagnation,¹⁹⁸ and generally affected women who disproportionately occupied minimum wage jobs more than men.¹⁹⁹ Perhaps most opaque to political criticism, but most pervasive, is the legacy of Fed policy from the inflation fighting era of the late 1970s through mid-1980s, which has kept the Fed focused on inflation rather than on inflation and unemployment as jointly-determined outcomes, leading to lower labor markets and an economy-wide lessening of labor's bargaining power.²⁰⁰

More directly, the managerial and financial changes that created the rise of the 1% also redirected corporate strategy toward the short-term stock returns immediately reflected in managerial and financial industry strategy choices and compensation, rather than longer term investment in labor and research.²⁰¹ They also likely contributed to the other dramatic economic trend of the last forty years

197Freeman, "Unionism and the Dispersion of Wages"; David Card, Thomas Lemieux, and W. Craig Riddell, "Unions and Wage Inequality," *Journal of Labor Research* 25, no. 4 (December 2004): 519–59, doi:10.1007/s12122-004-1011-z.

198David Card and Alan B. Krueger, "Minimum Wages and Employment: A Case Study of the Fast Food Industry in New Jersey and Pennsylvania" (National Bureau of Economic Research, 1993), <http://www.nber.org/papers/w4509>.

199Mishel et al., *The State of Working America*.

200Mishel, Schmitt, and Shierholz, "Wage Inequality."

201Davis, *Managed by the Markets*; Foroohar, *Makers and Takers*.

—the long term decline in productivity growth.²⁰² Both executive compensation-related behavior and financialization shifted organizational practices toward short term horizons, disinvestment from labor and R&D, and reorientation toward financial manipulation rather than long-term productivity improvement through technology or organizational improvement.

Investments in labor quality—assuring a long-term, highly committed workforce, or reorganizing production to ensure learning and adaptation over time—generally are long-term investments, often at short-term increased costs. These, in turn, depress stock value in markets looking for short term returns. Anecdotally, the story that Rana Foroohar tells of GM CEO Robert Stempel's effort to move GM to lean production in 1991, which broke on the shoals of demands from the board and Wall Street to focus on quarterly returns illustrates the shape of the problem problem.²⁰³ R&D investment has a similar temporal problem. Once investing in the quality of the labor force becomes too costly in the short term, management views of labor shift from a source of value to a cost center, and become a perennial target for cost cutting. The rise of offshoring and outsourcing; temp agencies that employ whole divisions that no longer count as part of the firm all contribute not only to the return of the top 1%, but also to a weakening of bargaining power and a kind of deskilling of the middle class.²⁰⁴ Political investments in weakening labor, both as a negotiating force and a political force, become increasingly a matter of personal income preservation to managers, and the casualization and externalization of labor contribute to that weakening, and are expanded in turn in the face of weaker labor bargaining power. By “deskilling” of workers here I don't mean loss of education relative to technological change, as in the standard SBTC story. I mean that the change in the conception of labor led to a decline in the possibility and framework for workers to develop firm-specific knowledge. A critical component of the efficiency wage hypothesis, for example, was that employers are willing to pay workers above market wages in order to induce workers to make firm-specific investments, so that they could become more productive workers in more productive firms.²⁰⁵ More recently, extensive work in management science has shown that a critical component of reorienting an organization to become a learning organization and engage all its workers in improving the organization's efficiency depend on this kind of long-term commitment and firm-specific and even site-specific knowledge.²⁰⁶ But if financial market expectations and stock-based compensation make it impossible, or at least very expensive, for managers to invest in labor, then those productivity gains to be made from investing in employees gaining firm specific skills are impossible to obtain. Cost cutting in the name of shareholder value, implemented through layoffs, casualization of labor through outsourcing and offshoring, and shifting corporate profit making from real economy to finance (in the form of GE Capital) were all central to the rise of Jack Welch to CEO superstar status. It is these set of practices,

202Lawrence Summers, “Taking a Long View on Corporate Reform,” *The Washington Post*, August 9, 2015, https://www.washingtonpost.com/opinions/taking-a-long-view-on-corporate-reform/2015/08/09/c786cdb8-3d0c-11e5-9c2d-ed991d848c48_story.html?utm_term=.2058088c19ab; Roger L. Martin, “Yes, Short-Termism Really Is a Problem,” *Harvard Business Review*, October 9, 2015, <https://hbr.org/2015/10/yes-short-termism-really-is-a-problem>; Andrew G. Haldane, Richard Davies, and others, “The Short Long,” 2011, <http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2011/speech495.pdf>; John R. Graham, Harvey R. Campbell, and Shiva Rajgopal, “The Economic Implications of Corporate Financial Reporting” (Working Paper, January 11, 2005), https://faculty.fuqua.duke.edu/~charvey/Research/Working_Papers/W73_The_economic_implications.pdf.

203Foroohar, *Makers and Takers*.

204Erin Elizabeth Hatton, *The Temp Economy: From Kelly Girls to Permatemps in Postwar America* (Philadelphia: Temple University Press, 2011).

205Shapiro and Stiglitz, “Equilibrium Unemployment as a Worker Discipline Device.”

206Beer, Eisenstat, and Foote, *High Commitment, High Performance*; Ton, “Why ‘Good Jobs’ Are Good for Retailers”; Heckscher and Adler, *The Corporation as a Collaborative Community*.

born both of managerial decisions driven by the compensation model and by the financialization of non-financial firms, that created both the rise of the 1% *and* the stagnation of median wages, while at the same time offering plausible causal mechanisms for a decline in productivity. This extensive work on the negative effects of stock-based compensation on managerial decisions offers a range of mechanisms to explain the growing literature that suggests that when an advanced economy's financial sector gets too large, its productivity declines.²⁰⁷ That effect, in turn, is exacerbated by the misallocation of talent—when the physics Phds build ever-more sophisticated hedging algorithms rather than working on exotic new nanomaterials or sustainable energy sources. While the concern with misallocation of talent at the high end is longstanding,²⁰⁸ and there is evidence that it does in fact occur,²⁰⁹ it is not yet clear how important its aggregate effects are relative to the other negative effects of stock-based executive pay and financialization. It is also possible that the winner-take-all market structure creates a selection effect: as the returns from executive rent extraction increased, the position drew and rewarded corporate leaders who were willing to cheat to get their way. Enron and Worldcom come to mind, but there is more sustained empirical evidence that firms that adopted stock-based compensation had higher proportions of fraud and were more often required to restate their accounting reports.²¹⁰ But by comparison to the broad systemic disinvestment in labor and R&D, it seems likely that these high-end talent misallocation and negative selection effect on cheats in the executive suite are likely less systematically important than the dramatic structural changes in managerial patterns.

The dynamics at the top, the middle, and the bottom of income distribution are not independent of each other, but they are distinct. Financialization led to disinvestment in labor, including offshoring, outsourcing, and casualization, all of which contributed cost-cutting to short-term bottom line and diminished the bargaining power of labor. Information technology certainly facilitated the complex tasks of supply chain management associated with offshoring or outsourcing, and helped manage a contingent workforce. But it was at least as much or more a function of shifting managerial professional norms, financialization, trade laws and the arbitrage it permitted between labor conditions in different countries as a function of new technological affordances. Union decline removed a major constraint on CEO compensation, as it reduced labor's bargaining power and the political power of the economy-focused (as opposed to identity-focused) left. It therefore led both directly to a loss of share of the rents available for distribution, and indirectly to power in designing the institutional and normative framework within which businesses operated and continued to restructure the organization of production and the relative power of labor, management, and capital.

The basic lesson of the political economic of the past forty years is that power across several interconnected social systems, not technology mediated by self-regulating markets, drove both productivity and distribution. Much of my discussion to this point was intended to exclude the dominant claim that markets operating independently of other systems, affected by technology as an exogenous force and incorporating its effects as changes in productivity were the primary driver of inequality. But it also goes against single-cause explanations such as the rise of the power of business lobbying or campaign finance laws, or the emergence of neoliberalism as a governing ideology of

207Arcand, Berkes, and Panizza, "Too Much Finance?"; Cecchetti and Kharroubi, "Why Does Financial Sector Growth Crowd out Real Economic Growth?"

208Tobin, J. (1984), "On the efficiency of the financial system," *Lloyds Bank Review* 153, 1–15.

209Goldin, C. and L. F. Katz (2008, May). *Transitions: Career and Family Life Cycles of the Educational Elite*. *American Economic Review: Papers and Proceedings* 98 (2), 363-369, pp 365-66.

210B. S. Frey and Margit Osterloh, "Yes, Managers Should Be Paid Like Bureaucrats," *Journal of Management Inquiry* 14, no. 1 (March 1, 2005): 97, doi:10.1177/1056492604273757.

global elites. Instead, I suggest that the dynamics of both declining productivity and increasing inequality reflect the interaction of several systems: knowledge, both high cultural and popular; social norms, both society-wide and professional or local to a context of interaction; organizational practice; political and legal; as well as technological and economic. Across all these systems, power, or the ability to impose outcomes, beliefs, preferences, and constraints on others, was the determinative factor.

The era of Oligarchic Capitalism was typified by the aggregation of power across these many dimensions in a small percent of the population. Some of it was classically oligarchic—in the sense of the wealthy using wealth to obtain political power to preserve and increase their wealth.²¹¹ The shift in political expenditures and the rise of Organized Business is the part of the story that most directly fits that model.²¹² Part of it reflected a deep shift in the intellectual environment, as Progressivism and Keynesian economics gave way to neoliberalism at the broadest macro level, and managerialism gave way to shareholder value at meso-level applications of these broader intellectual shifts to organizational practice. Part of it reflected broader popular culture perceptions of individual fulfillment and achievement, which had both left and right wing versions. Part reflected unintended consequences of institutional choices made over the objections of oligarchic elites, like the large influx of foreign capital that allowed the Reagan White House to continue to run deficit spending but maintain a strong dollar over the best efforts of major exporters, or the drive of Silicon Valley to preserve stock options whose primary influence ended up shaping the 1% through compensation in more traditional industries. Union decline certainly was the purpose and intent of Ronald Reagan and Margaret Thatcher, but it also reflected the fragmentation of the left and the emergence of consumers and workers as opponents, rather than allies, in the deregulation battles of the 1970s. Any serious effort at projecting the likely effects of the current technological transformation on the economy and society has to locate that analysis in these other systems, and has to understand it in terms of power. Efforts to analyze robots or platforms from the perspective of how they affect productivity in a more-or-less well-functioning, self-regulating market is simply ignoring how social economic practice and large scale trends in both productivity and distribution have in fact unfolded.

Where do we go from here?

If we are to overcome the democratic crisis that mature Oligarchic Capitalism has wrought, we will need solutions that operate across all the various dimensions of power that built that system. My purpose in this essay is to outline the dimensions that caused inequality in order to offer a framework for organizing our thoughts on the solution. Here, I briefly sketch the elements of such an alternative approach, although the details will have to await later work.

One class of approaches that the analysis I offer here is intended to exclude is, broadly-speaking, techno-liberalism. These mix libertarian and progressive ideals (although there is a more explicitly techno-libertarian version, most prominently embodied by Peter Thiel) that take the settlement of the past forty years as given, and project that with enough economic dynamism, technology will lead us to an age of abundance so that will eliminated economic insecurity. The primary institutional proposals shared by these approaches are a much deeper investment in education, particularly a belief that better educational technology will improve outcomes,²¹³ and a universal basic income that will redistribute the gains from those who are the winners in a “naturally” winner-take-all

211 Jeffrey A. Winters, *Oligarchy* (Cambridge ; New York: Cambridge University Press, 2011).

212 Hacker and Pierson, *Winner-Take-All Politics*, 2010.

economy, to those who lose out in it, so that those who lost are free to develop their own projects and continue to innovate, feeding the virtuous cycle. There are deep divisions regarding just how generous the basic income should be; how public the education; how big a role technologically-enhanced municipal government can be and so forth. But part of what is interesting about this class of answer is that it is effectively a continuation of the elite détente of the past forty years (leave the institutional foundations of oligarchic extraction largely untouched but assure equal dignity to diverse ethnic, gender, race populations; and strive for equal opportunity to compete in the otherwise-unperturbed market structures), coupled with a Panglossian progressivism about the power of technology to liberate humanity from want.²¹⁴

But there is another answer that assumes that scarcity will not be repealed, and yet we must find a model for an open social economy that will provide broad-based economic security without sacrificing dynamism and without resurrecting ethnic and patriarchal sources of solidarity. It combines insights that emerge from the mainstream of the economics profession under the moniker “inclusive growth” with foundational challenges from networks, commons, cooperation, and complexity aimed at creating an open social economy. It insists that markets are arenas of power, not spontaneous order; that economic security and equality are integral to the institutional design of markets, and that the two cannot be separated, analytically or practically; that diversity of institutions, motivations, organizational forms, and normative commitments is the normal state of affairs, and that there is no convergence on an efficient equilibrium on any of these dimensions. We have seen remarkable victories in the form of the Fight for 15 movement through agile advocacy, networking collaborations across locations, sectors, and targets wherever it can be most effective. We have seen local victories, most clearly that of the Barcelona en Comu party, now translating into significant efforts at integrating municipal with non-governmental efforts to build a collaborative economy. These victories represent the feasibility of a combination of strategies for economic reorganization, including action focused on private firms, municipalities, and states, and perhaps most importantly a reshaping of broad social norms and the basic intellectual beliefs that govern public and private, political and economic decisions.

Just as managerial capitalism was based on progressivism, and oligarchic capitalism was based on neoliberalism, the open social economy is based on developments across a wide range of academic disciplines that offer micro, meso, and macro-level understanding of human motivation and action. These have not to date been articulated as a coherent alternative, but taken together provide a way of understanding economic production and growth that neither collapses back to the expertise-based command and control system that typified old progressivism nor perpetuate the myth of efficient markets that has been the legitimating force of oligarchic capitalism.

We have seen a shift in the nature of our understanding of rationality from *homo economicus*, a uniform model of self-interested rational action, to *homo socialis*, who has diverse motivations that are socially-oriented and respond to the social setting and situation. We have seen a move from competition as the sole organizing concept of economic activity, to seeing cooperation and competition as complements. We have seen a move from optimization based on property and contract as the

213This strong emphasis on technology as the solution to fundamental broad social problems is the core of Morozov's critique of Silicon Valley-centered progressivism. See Evgeny Morozov, *To Save Everything, Click Here: The Folly of Technological Solutionism*, Reprint edition (New York: PublicAffairs, 2014).

214Gregory Ferenstein 11 08 15 11:00 AM, “The Politics of Silicon Valley,” *Fast Company*, November 8, 2015, <https://www.fastcompany.com/3053318/the-politics-of-silicon-valley>.

fundamental institutions of interaction, to a mix of commons and property, or governance and participation rather than arms-length bargaining as the core model of organizing production. We have seen a shift from optimization to experimentation and learning as the core model of technical design—most clearly of the Internet itself—and organizational strategy. More generally, the past quarter century marks a broad shift from the idea of uniformity of optimal solutions—of motivations, institutions, and organizational forms—to diversity and continuous experimentation. Rather than understanding the investor-owned firm as the core economic organization in modern economy, we are seeing an explosion of experimentation with organizational forms. Firms themselves have persistently diverse organizational models—the management science literature is rich in examples of firms that sustain “good jobs” or “high-commitment, high-performance” strategies to outperform their competitors while offering higher wage, greater stability, and greater autonomy to workers, gaining in return a more knowledgeable workforce with higher initiative, a cooperative dynamic, and the team gains they yield. Long ignored by mainstream economists and policymakers, the non-profit and government sectors have been absolutely central to the core growth areas of economy and society—healthcare, education, and innovation. On the flip side, we are seeing experimentation with using LLCs, B-corps, and other fully or partly for-profit forms instead of the purely for-profit form to attain social goals. We are seeing a resurgence of interest in cooperative ownership by workers or consumers. And we are actually seeing a range of unincorporated networks of individuals working together to organize productive activity, again, most clearly with free and open source software, but now moving to real-world models like emerging makerspaces or urban farming.

In all these areas, from “hard-nosed” business disciplines and hard science evolutionary biology to ethically-driven activist practice, we are seeing that uncertainty and human fallibility cannot be solved by perfecting property and contract or getting self-interested incentives just right. We are seeing that identity and participation are central to the flourishing of business firms no less than they are to the flourishing of communities. We are seeing that values-orientation, flexibility, autonomy for self-motivated exploration and cooperation combined with economic security, rather than contingency and competitive self-interest drive functionally superior economic performance. From these building blocks we can, and must, synthesize a much more foundational alternative to both the settlement of the past forty years and the rising economic nationalism in the United States and Europe. These foundational and social-practice changes must then be integrated with the emerging program that developed under the “inclusive growth” paradigm within more traditional economic work—covering reforms of labor and employment law, national and international tax regimes, and macro-economic policy oriented equally toward labor market effects as towards inflation, rather than the present strict emphasis on inflation. Only by integrating some of these macro-policies that can only be implemented at national or even international scale, with the meso-organizational and micro-behavioral changes toward a more social economy, can we break the systemic effects that led to the rise of oligarchic capitalism. Failure means that continued broad economic insecurity and sustained identity threat to pluralities in the populations of market societies will continue to generate fertile ground for parties and leaders all too happy to exploit these anxieties to divert attention from oligarchic extraction to enemies of the state and the people, both internal and external.