

Too Much Wealth, Too Little Democracy

Interview with Kevin Phillips

*Kevin Phillips's new book, **Wealth and Democracy**, has climbed onto the nation's bestseller lists. This long-time political scientist believes growing private wealth and great inequality have undermined democracy in the United States. In this interview, he goes beyond his book and provides a surprising set of strong proposals for reform.*

Q You have been concerned about the rich and the poor for years, but it seemed to me when I read your new book, *Wealth and Democracy: A Political History of the American Rich*, that your anger has reached a higher level, a more intense level. Am I right, and why is that?

A. That is right, and I would say it has something to do with the stages of this particular capitalist-conservative go-go period.

KEVIN PHILLIPS is author of *Wealth and Democracy: A Political History of the American Rich* (New York: Broadway, 2002).

As of right now, with the peak having come sometime two years ago, we are at a stage that presents many more problems than when the rise of inequality and the making of great fortunes started in the 1980s. Second, I found myself pulled even more than before toward the notion that we now have a particular problem because the United States is so exposed to the international economy. The United States is sporting an incredible current-account deficit that the British did not reach until 1947 or 1948 as a proportion of gross domestic product [GDP]. Earlier, the British had crowed, as we do now, that the merchandise trade deficit was no problem. But by the post-1945 period, their current account deficit spelled big trouble for them, just as ours is now a big, flashing red light.

Q But how do inequality and the accrual of wealth in themselves affect or result from the trade and current-account deficit?

A. For one thing, when a country reaches the stage of what I describe as financialization, it usually means rising inequality because it is moving away from what it used to do that was somewhat more egalitarian, or at least less unequal in its effects, whether it was manufacturing or fishing or farming. That has been the pattern of finance, whether it was in Spain or Holland or Britain. Take New York City, a center of inequality. The New York state comptroller's office reported that something like 55 percent of the income growth in the city of New York between 1992 and 1997 came from the securities industry alone.

Q. Explain more clearly what you mean by financialization.

A. Financialization, in the broadest sense, has to do with the considerable increase of the role in finance in a society, especially one that is becoming more globally important and sophisticated compared with what that country used to be. My definition for the United States in the 1980s and 1990s would be

as follows: Several phenomena facilitated the surging of finance. One was the closing of the gold window and floating the currency. Then, related to that, was deregulation, which got rid of the ceiling on interest rates paid by banks and facilitated a proliferation of financial instruments. What really empowered that proliferation, as a third factor, was the rise in computerization, which obviously made possible all these new financial strategies, including hedging by using options and derivatives. As a backstop, beyond these factors, you had what I think was absolutely central in the role that financialization achieved—and that is the extent to which the Federal Reserve, the Treasury, the Federal Deposit Insurance Corporation, and other, lesser agencies, periodically reinforced by the International Monetary Fund, the World Bank, and several other institutions, basically rescued the financial sector time and again. We had discussions in the United States in the early 1980s about an industrial policy to benefit manufacturing sectors, but it was never adopted. Instead, what we really got, with nobody voting on it and nobody even understanding it, was a “financial” policy, so to speak. This policy developed across two decades: from the early 1980s, with the rescue of the Latin American debtor nations so they would not default to the American creditors, to the rescues and bailouts of Continental Illinois, the Texas banks, and the savings and loans—the sky was the limit.

Then look at Alan Greenspan’s rescue of the stock market in the 1987 crash. There are other things that came along, like the Fed’s complicity in bailing out Citicorp in 1991–92. There was the bailout of the Mexican peso and the high-paying debt instruments that would have failed if the peso had failed—that could not happen to the good friends in New York, so that was bailed out. Then there was the bailout after the Long-Term Capital Management crisis, and the flood of credit out of fear of Y2K. I guess I would sum it up as the most conspicuous example in the twentieth cen-

tury of the Fed favoring one sector of the economy. By the mid-1990s, as a proportion of GDP, the FIRE sector—finance, insurance, and real estate—exceeded manufacturing. By 2000–2001 it went ahead in profits. And this government policy-making is exactly the reverse of free enterprise. It is neo-mercantilism for finance, it is state capitalism, it is socialized credit risk, it is everything that free enterprise theory says should not be done.

Q You are not outright saying it should not have been done—you are saying we should have recognized what we were doing and balanced it more?

A. Free enterprise theory says it should not be done. Indeed, I would say that a lot of it should not have been done. I would say: Let some of those Latin American nations default on Citicorp and Chase Manhattan. Don't bail out after the 1987 crash. Don't bail out above the \$100,000 FDIC insurance level to help big depositors. Don't rescue Long-Term Capital Management because it is run by pals of some foreign central banks, and some former Fed people were hooked up with them. Let them take a bath like Paul Volcker said they should. Those are just some examples.

Q. You mean over these twenty years?

A. Yes. If we had not bailed out the way Greenspan bailed out, the Dow would never have gone above 6,000 or 7,000 maximum. We would not have had a lot of the bubble. And, of course, bank stocks would be worth about a quarter of what they are worth now after all the splits and gains.

Q It is interesting that in their book, *The Fabulous Decade* (New York: Twentieth Century Fund, 2001), Alan Blinder and Janet Yellen say that the Fed was ready to raise rates in 1997 until the Asian financial crisis.

A. It is useful to compare the role of the Fed (not that I am any kind of great expert) in the 1920s with its current role. Among the accusations at that time were that because they wanted to support European currencies, notably the pound and the franc, too much liquidity was pumped into the system. Then, by 1931 or 1932, they were too anxious to keep the profits up for U.S. banks, so they declined to allow interest rates to fall further because the banks would not have made any money on their bonds.

Q. Yes. John Maynard Keynes wrote his famous essay, “The Consequences of Mr. Churchill,” on the high pound in 1925.

A. It was not just 1925, it was 1927, too, amid the currency instability. But the point is that the Fed was going AC/DC, pumped up sometimes and other times bailing out the banks, and was an inconsistent manager, as in 1997–2000.

Q Let us try to put a little picture on how wealth has expanded since the mid-1980s. How do you express it?

A. In a nutshell, wealth expanded very well for people who had capital and particularly had capital tied up in the stock market. The thirty richest individuals and families in 1982 had wealth that ranged from \$500 million up to \$8.6 billion—that was the Du Pont family. By 1999, seventeen years later, the range of the top thirty families and individuals had climbed to \$7 billion to \$85 billion. That is because that wealth was essentially tied to the stock market. The average wealth of the Forbes 400 rose some tenfold. And most of the CEOs who had megabucks would have been in the top one-tenth of 1 percent. They did even better than the Forbes 400 in percentage terms because the average compensation of the ten most highly paid CEOs in 1980 or 1981 was \$3.45 million, and by 2001 had gone to \$155 million.

Q. They even outpaced the stock market!

A. Certainly their performance was not tied to the stock mar-

ket except insofar as you could game your stock prices at certain intervals and pack the compensation committee with fellow grave robbers.

Q. To put it in perspective, nominal GDP only doubled over this period, more or less.

A. Yes, you only have to take off half to get real gains, so the real gains of the top thirty in the Forbes list were 500 percent. For the ordinary American, the average household cash income, adjusted for inflation, increased from about \$31,900 to \$33,200 between 1979 and 1997.

Q How does that compare with, say, wealth creation in the immediate post–World War II period?

A. The period that several economists call the “Great Compression” after World War II showed that the biggest growth was actually in the middle part of the income distribution, which would be the middle three quintiles. But from the late 1970s through the late 1990s, which is what I call the “Great Inversion,” the weighting was to the top quintile, and in particular to the top 1 percent.

Q How does the wealth creation in the last fifteen years compare with wealth creation in the other great periods, the Gilded Age and the Roaring Twenties?

A. The wealth creation in the 1980s and 1990s was much more substantial than in the 1920s in the longer scheme of things. There are no good data for 1929. The guesstimate is that there were about 30,000 millionaires, and that was up from perhaps 7,000 in 1921 or 1922. So you can say that the number of millionaires increased by four or five times. Now, between 1990 and 2000, that is probably also roughly true. But in terms of the growth of

the great fortunes, these were bigger in the 1980s and 1990s than in the 1920s by far. Besides, a lot of the fortunes in the new industries did not make it through the crash. You do not see much in the early 1930s for aviation, broadcasting, that sort of thing.

Q. You mean fortunes from those industries?

A. Fortunes from the new tech industries of that era.

Q. And what about the Gilded Age? What period is typically designated the Gilded Age?

A. Mark Twain coined the term in 1873, and you can debate whether it goes up to 1904 or 1906 or 1907, somewhere in there. The wealth creation in the post-Civil War period, from 1860 to 1875, was enormous. Vanderbilt, for example, had maybe \$12 million or \$15 million in 1861. When he died in 1876, he had something like \$115 million, so there was a huge increase. But that was not achieved by anybody but him. The Astors had a little less. The greatest broad-based increase came in the 1880s and 1890s when the steel and oil fortunes came into play. They were the big ones. Their expansion would have been comparable to what high tech did during the 1980s and 1990s. The great parallel is that in the Gilded Age there was a railroad wave, and then a steel and oil wave that, probably in the hands of Carnegie and Rockefeller, produced gains roughly equivalent to the tech gains in the 1990s. I do not remember in great detail what happened to the oil and steel fortunes in the 1903 and 1907 market bottoms, but obviously tech was dismantled in our time—not the solid portions, but many of the new fortunes, much like what happened to aviation, consumer gadgets, and radio in the 1929 and 1932 period.

Q So, you are saying that this period is quite comparable to the Gilded Age?

A. It is quite comparable in terms of the momentum and

buildup of fortunes. It is not comparable in the extent of financialization, which is massively greater during this period.

Q. The fortunes of that early period, however, were probably greater as a proportion of GDP?

A. I am not sure. The only way that I tried to compute them was the relationship between the *largest* pot of wealth in the United States and, hard as it is to come up with good data, the approximation of *average* family wealth of the period. John D. Rockefeller, in about 1905 or 1910, was something like 1.25 million times as wealthy as the average family. Gates was a little higher: he got to be 1.4 million times as wealthy in 1999. I do not regard the GDP percentage as historically useful. Maybe it is appropriate for the 1890s, but if you use it for the period in which Astor and Vanderbilt were operating, the United States was too small—it did not have the population, it did not have the mass.

Q The United States was already the largest economy in the world in 1890. Let us compare political power. Are you concerned that the wealthy have more, or the same, political power now as the rich did in the Gilded Age and the 1920s?

A. It is a pretty close run between now and then. That, in itself, is damning because the conclusion, whether it was by Teddy Roosevelt or many others, was that the rich had way too much power by the first decade of the twentieth century. The progressive responses to these circumstances were inheritance taxes, progressive income taxes, serious antitrust legislation, major regulation at the state and federal level, and then, more specifically, prohibitions in campaign finance that Roosevelt pushed through—I forget exactly what they were, but they applied to the corporations—in 1906. Then, in 1913, they passed the Seventeenth Amendment to the Constitution, which provided for

direct election of senators. It took this power away from state legislatures, which had been, in essence, bought by multi-millionaires who wanted a Senate seat.

Q. The U.S. Senate then was highly conservative or pro-business, or pro-money?

A. It was a burial ground for any type of progressive legislation. Things could get through the House, but they would die in the Senate. That was when the muckrakers wrote books and articles like “The Shame of the Senate,” and so forth; it was just corrupt. One senator, responding to a proposal not to seat any of the senators who were suspect for having allegedly bought their elections, said if we did that, we would not have a quorum.

Q. How do you define the equivalent of political power among the wealthy now? How does it manifest itself?

A. State legislators are not the focus, although you could probably find plenty who are controlled by the business interests in their states. I would say that dollars have been deployed to make it very difficult to get any sort of inhibition of business and financial power through Congress and the White House. Only in 2002 have signs of change begun to emerge.

Q. Any sort of regulation or restriction or restraint?

A. Yes, they basically do not want to deal with anything that would be unpopular with business. And the FIRE sector is number one in political contributions and number one in lobby outlays. Then you have roughly the 11-to-1 ratio of business and finance over labor. Even Democrats, who are in the middle of their party or slightly to the left of the middle, still have to get money from more liberal or opportunistic business—which includes insurance, housing, finance, and tech. They have to get the money from the same people who have to be regulated.

Q Do you believe that in some serious ways the will of the people is being subverted?

A. Absolutely. There has been support for more business and financial regulation.

Q. What is the evidence for that?

A. The best evidence has come in three or four outbursts. You can see spasms of public outrage over the last ten years. One was in the popularity of Ross Perot and his criticisms of multinational corporations. A second was the appeal of Pat Buchanan in New Hampshire when he talked about killer CEOs and won the 1996 Republican presidential primary; then there was John McCain talking about the two parties being in a conspiracy to sell the country to the highest bidder, which is how he described the campaign finance laws. Then there was the great response in the universities to Ralph Nader's corporation baiting in 2000. There has been a willingness to respond to these issues, it is just that you do not see many people raise them.

A second facet is a decline in the percentage of Americans who vote, to levels in the last ten years as low as 49–50 percent in presidential elections and 37–38 percent in congressional elections. The income groups whose voter-participation rates have dropped the most are the lowest three quintiles. They basically say in surveys that it does not make any difference whether they vote, that the special interests dominate, nobody listens to people like them, and so on.

Another aspect is the extent to which, for want of popular participation, politics is increasingly dominated by people in the upper-income brackets. The top 40 percent—I am not sure of this number—cast maybe 60 percent of the votes. The recent economic dialogue of American politics—the extent to which you can have George W. Bush talk about the inheritance tax, which first came on the books under Lincoln and McKinley in the Civil

War and the Spanish-American War, and which he calls the death tax—bespeaks an amazing transformation. Democrats do not call him on it very much.

Q Some would argue that people just do not care. They are not exercised about these issues, or they might care a little bit, but not very much.

A. They care periodically, but tell me who is raising these issues. In other words, when you get people raising them like a Perot, a Buchanan, a McCain, a Nader, you have some effect. But when the opposition consists of people who received the second-best contributions from the same interests that funded the majority, you do not get much independence.

Q How did this ideological attitude change during the Progressive Era and the New Deal, which followed periods of great wealth accumulation?

A. One of the important change factors is an implosion in the markets, which then feeds into the real economy, whether it is the Panic of 1893 or the Crash of 1929. That begins to radicalize people, whether it is farmers, or workers in the 1890s, or the millions of people who lost everything from nest eggs in banks to jobs during the Depression. Now we are starting to have a kindred framework for people to say, What son of a bitch made my 401(k) into a 201(k)?

Q Do you believe there will be a swing of the pendulum toward progressivism as there was in the past?

A. You cannot have the pendulum swing too much unless you have three things. The first is the stock markets/financial

markets implosion, which certainly developed in June and July. The second is a major decline in the real economy, and there you have a question: How much post-9/11 stimulus from federal spending and Greenspan's last three rate cuts is still operating? Is the consumer flagging? Third, the whole 9/11 framework creates an alternative issues complex in taking people's minds off economics, just as World War II took their minds off the 1930s. This "x factor" has to be overshadowed.

Q. The unfortunate part of your analysis is that it would seem to require further crisis.

A. I think so, otherwise you are going to see the bailouts of the 1980s and 1990s continue in new forms. Greenspan may prefer the doldrums, Japanese-style, to any destructive market outcome that could unseat the political power structure and jeopardize the financial power structure. A decade ago, Greenspan came up with a great quotation: "We just can't tolerate a major wealth rearrangement of the sort that we've had before." I am sure you cannot tolerate it if you live on Park Avenue or Greenwich, but I suppose that an awful lot of ordinary people could tolerate it pretty well. It is just that Greenspan's clientele cannot tolerate it.

Q But the political liberals, for the most part, were in favor of looser monetary policy.

A. Looser monetary policy, but I do not know what they favored on the bailouts because they did not say. They did have the thesis that a stock market Keynesianism was at work, and there is a lot of truth to that.

Q. What would you like to see done now?

A. Personally (it is not in the book because I did not propose policy there), I would come up with about five or six proposals. We can start as follows: First, I would like to see a tax structure that would go part of the way back to the 1950s. The 1950s were

a very good decade in the eyes of a lot of people. The tax structure back in the 1950s had about six different brackets for people in the top 2 percent of the country income-wise. It made an enormous differentiation between a million dollars and \$400,000 and \$75,000. Now, \$75,000 in 1955 would have been in the top 1 percent handily, but the point was that people really at the top had tax rates that were really at the top. Sure, they had some shelters, but most had not begun to shelter the amount of money to get them to a 28 or 35 percent effective tax range. Their effective tax was a hell of a lot higher. So I would favor a six- or eight-bracket tax policy. Beginning at one-million-dollar incomes, for example, we can have rates of 40, 44, 48, 52, and 56 percent. The last of these might start at \$50 million a year.

Q. You said four or five things. What else?

A. Second would be public funding of elections. Get Enron's hand out of Congress, get WorldCom's hand out of the House Commerce Committee. That might require a constitutional amendment. I would not have any problem with a constitutional amendment that said: Political contributions are not free speech.

Third, I think we could have a second New Deal in terms of reregulation of the behavior of corporations, the investment community, CEOs, and boards of directors. My reason would be as follows: Just as the 1920s were such a growth period for finance with all kinds of new devices—whether they were boiler rooms, mutual funds, or flagrant insider trading—all of them were new enough that they were not in the regulatory ballgame at the time. In other words, the 1920s had outrun the regulatory framework. Likewise, in my opinion, the 1980s and 1990s outran the regulatory framework that existed in the 1970s. I would say it is now time to have a round of Securities and Exchange Commission and other related legislation that attunes the regulatory framework with the emerging malpractice and gimmicks and techniques of the 1980s and 1990s.

Q. Anything else?

A. Something I would really like to see, but I just do not think it is plausible now—although the public would probably support it by overwhelming margins if given the decision—is some form of corporate pay-scale democratization. Why could shareholders not be required to approve CEO compensation? I think that would be wonderful.

Q. In a more direct way, there is probably some way they can vote on it.

A. Here is another reform of the legal basis of corporate activity I would favor (and, again, I cannot imagine it would be instituted by the same politicians who rely on these people for little white envelopes that crinkle nicely when you squeeze them): a clarification of the Fourteenth Amendment, which was interpreted in the 1880s to establish corporations as persons who were entitled to similar rights. I do not see how any entity created by a public body, and all corporations are, is entitled to due process against the government.

Q Let me ask you just one or two last questions. You are always described as a former Republican adviser.

A. I was very much involved in the Republican Party back in the day when it was an anti-establishment crowd trying to bump off what we could call the liberal establishment.

Q. What years are we talking about?

A. We are talking about the late 1960s and early 1970s. You have to remember that the Republican platform in 1972 had a plank that opposed multinational corporations' moving jobs overseas. We are talking about a different breed of cat. That was a party that talked about Middle America. The Nixon administration had many failures, but sucking around the Business Roundtable crowd was not one of them.

Q. Are you still a Republican adviser?

A. No, certainly not. I have not been in any way active in the Republican Party since the 1980s. I am not a Democrat. I call myself an independent, but if John McCain were to run against Bush in a primary, I would really think about registering Republican so I could vote.

Q. How do you think the Bush administration will fare in these corruption crises?

A. This administration does not want to regulate business. However, it is going to be an extraordinary challenge for it to get through the next three years without doing so because of the public's displeasure over the crony-type relationships between the president, the vice president, and the business community.

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