The Regulatory Roots of Inequality in America

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Abstract
Why has U.S. income inequality surged to unprecedented heights since 1980? The propensity for inequality to increase is not simply the natural result of differential rates of return but is powerfully driven and/or constrained by politics and policy. This article explores the underlying mechanisms with a focus on market governance, including corporate governance, financial regulation, labor relations, antitrust, sector-specific regulation, and intellectual property rights. Firms and individuals actively shape market governance in their own favor and then take advantage of that favorable governance in the marketplace. And that drives the accumulation of inequality, especially in the United States of the past four decades.

The basic facts are now familiar: economic inequality has risen substantially since the 1970s in most industrial countries, and particularly sharply in the United States. The U.S. surge is unprecedented in that it is driven more by inequality in income than by inequality in wealth. This severe inequality denies ordinary workers the fruits of their labor, constrains economic opportunities, impedes economic growth, and compromises the legitimacy of the political and economic system. U.S. labor productivity has continued to rise over this period, but most people have not benefited from higher wages or a better standard of living. The returns from economic growth have gone disproportionately to the most wealthy within society: the top one percent, and especially the top one-tenth of a percent (see Figure 1).

Figure 1. Pre-Tax Income of the Top 1% and the Bottom 50% of U.S. Income Earners

Source: Piketty, Saez and Zucman 2018.
Market governance is not the sole cause of inequality, but is pivotal to the core dynamic of the accumulation of inequality, especially in the United States since 1980. Market governance includes everything from corporate governance to financial regulation, labor regulation, antitrust, and intellectual property rights. I refer to this as “marketcraft” because it constitutes a core function of government roughly comparable to statecraft. Government activity of this kind does not constitute artificial intervention into a natural market but is rather a prerequisite to a functioning market. All markets are governed, so the question is not whether the government should intervene or not, but rather how it should structure markets, to what ends, and for whose benefit. Marketcraft is often structured to favor those with wealth and power rather than to distribute rewards to those who exercise the greatest skill and effort. This makes it inefficient as well as unfair. It is inefficient because market actors are not given the appropriate incentives to perform: some are over-rewarded for skill and effort while others are under-rewarded. Individuals are denied opportunities due to labor regulations and racial and gender discrimination, and firms are denied opportunities due to lax antitrust rules and anti-competitive practices.

The government plays a critical role in expanding or constraining inequality by setting the terms of market competition. The core relationships in a market economy – such as those between employers and workers, borrowers and lenders, and producers and consumers – are relationships of power. The rules of the marketplace define the balance of power among these participants, and the balance of power in turn affects the outcomes of the bargaining, such as contract terms, the allocation of risks, and prices. These rules include formal laws, informal business practices, and social norms (Vogel 2018, 9-14). The alternative to government regulation is not free markets but rather private sector market governance, which is particularly susceptible to collusion and fraud. In fact, government regulation is the primary means to press companies from collusion toward competition, and from extractive to productive strategies. Market governance does not “redistribute” income or wealth, but rather shapes the distribution of returns in the first place. Therefore, better market governance could produce a more equitable and more productive market economy in the United States.

Some scholars blame technological progress for inequality, arguing that it has delivered the greatest returns to high-skill work and displaced many lower-skill workers (e.g. Autor, Katz and Kearney 2006). Others point to globalization, contending that firms can seek higher returns anywhere in the globe while most workers are tied to a particular location. Firms can move production abroad where labor is cheaper or they can outsource services to staff centers abroad. And this undercuts the wages and benefits for lower-skill workers in the industrial countries. Yet these explanations cannot account for the increasing gap between most college-educated workers and the top 1%, or for the considerable variation in the scale and nature (such as income versus wealth) of inequality among the industrial countries (Hacker and Pierson 2010, 34-7; Piketty, 2017, 382-97). In any case, these factors are themselves propelled and constrained by government policies, and policies are rooted in politics. In fact, politics and policies not only explain variations over time and across countries; they also help to account for some of the similarities among countries since the 1980s because the advanced countries embraced similar policies of tax reform, spending cuts, privatization, and “deregulation” during this period.

This then raises the political economy puzzle of inequality in America: Why did the government do so much to exacerbate inequality and so little to moderate it? The U.S. government boosted inequality by taxing wage income, which accounts for most income for the lower and middle classes, at a higher rate than capital gains, which overwhelmingly go to the wealthy. It offered tax breaks that disproportionately benefitted wealthy citizens, such as mortgage interest
deductions, and favored large corporations, such as research and development deductions. It provided welfare for big business such as research subsidies for manufacturers and production subsidies for agricultural firms. And as stressed above, it engaged in marketcraft that systematically favored the wealthy and powerful over everyone else.

Thomas Piketty has documented trends in inequality from the mid-nineteenth century through the present in several major industrial economies. He demonstrates that inequality has risen in these countries throughout this era, with the important exception of the 1910-80 period. He argues that if the rate of return to capital exceeds the growth rate (the famous \( r > g \)), as it did through most of this period, then inequality will rise. Those with substantial capital will earn a return on this capital of 4-5%, while those without capital will remain relatively poor given slow growth (Piketty 2017, 33-4). The 1910-80 period is distinctive because the two world wars eliminated so much wealth and because governments raised taxes on income and inheritance to pay for World War I and did not lower those rates substantially until about 1980 (See Figure 2). Piketty enhances our understanding of inequality because he generates and analyzes new historical data; he clarifies the distinction between wealth and income inequality; and he differentiates several epochs of inequality. He also identifies national variations within the broader trends he observes, stressing that the U.S. rise in income inequality over the past few decades exceeds that of other countries by a substantial margin (Piketty 2017, 27-36, 365-81, 397-405). But he does not fully explain these national variations. His presentation is puzzling because he explicitly recognizes the primacy of politics and institutions but does not flesh out that side of the argument. He almost seems to call on other social scientists to fill in the missing mechanisms. This article seeks to contribute to that effort. It stresses that the propensity of inequality to increase is not the natural result of differential rates of return, as Piketty’s formulation seems to imply at some points in the text. Rather, firms and individuals constantly seek to shape market governance in their own favor and to take advantage of favorable governance in the marketplace, and that drives the accumulation of inequality, with varying success across space and over time.

Figure 2. Income Inequality: Europe vs. the United States, 1900-2010

![Graph showing income inequality: Europe vs. the United States, 1900-2010.](source: Piketty 2017, 409.)
Piketty’s differentiation between wealth and income inequality and his delineation of historical periods is helpful in sorting out the causes of inequality in particular periods of time. The elements of market governance examined in this article are more central to explaining the boom in income inequality in the United States since 1980 than in explaining the rise in wealth inequality from the mid-nineteenth century through the early twentieth century. Piketty’s focus on the basic logic of $r > g$ is more appropriate for wealth inequality because high returns to capital relative to economic growth will tend to produce higher inequality of wealth over time. His focus on tax policy as the primary remedy is also more applicable to inequality of wealth than inequality of income. Nevertheless, market governance also affects the inequality of wealth because inequality of income is the source of the wealth that is then compounded over time via investment. The regulatory structures of the late nineteenth century enabled market concentration and outsize rents in certain manufacturing sectors and in finance, producing the class of super-wealthy of that era in the first place. And of course market governance also affects the allocation of returns from investment. Moreover, recent economic research suggests that market concentration and financial rents tend to undermine growth, thereby shrinking the $g$ in Piketty’s $r > g$ formulation (Boushey 2019).

Piketty’s book title references Karl Marx, and he engages Marx directly in the text. Marx of course had his own theory of why returns to capital increase at the expense of labor. Marx subscribed to the labor theory of value, whereby labor creates all of the value in production. Capital only pays workers the minimum for survival and extracts the surplus value of labor. Meanwhile, technological advances allow capital to produce more with less labor, generating a growing reserve supply of labor. So wages continuously fall over time (Marx and Engels 1977, Marx 1977). While history has proven Marx wrong on this last point, he nonetheless offers a core insight that applies to our own era: markets are embedded in relationships of power. Market liberals such as Milton Friedman interpret market transactions as voluntary exchanges among equal parties, yet market relationships involve exploitation based on unequal starting positions (Friedman 1962). The capitalist begins with capital, and the worker begins with nothing but their labor. Marx’s view of the inevitability of exploitation nonetheless misses the variation across space and time just as much as the market liberal view does. And he focuses on the capital-labor relationship and not the broader range of market relationships in a capitalist economy (such as those in Table 1 below). His understanding of market exploitation is both too universal, in that it does not account for variation across time and space, and too limited, in that it focuses on the capital-labor relationship. Moreover, Marx – like Piketty – does not flesh out the mechanisms that reproduce power in market relationships, or the subtle ways in which market power begets social and political power and vice versa.

This article stakes out a position distinct from those who view increasing inequality as an inevitable feature of capitalism and those who view redistribution via taxes and welfare spending as a satisfactory remedy. It stresses, in contrast, that the propensity for economic inequality is driven by specific policies and business strategies, and therefore varies considerably across time and space. Firms and individuals lobby to shift market governance in their favor and then take advantage of these policy changes in the marketplace, and thus political and market power reinforce each other over time. But reforms can moderate or even unravel this snowball effect. Hence capitalism can only be reformed effectively from the inside out, by transforming the market governance that defines the power relationships in the economy.
The Accumulation of Inequality

This article focuses more on firms than on individuals because inequalities across firms and within firms are the primary sources of rising inequality in income in the United States since 1980 (Schwartz 2016, 228). Let us begin by postulating that firms seek not only to maximize profits but also to secure stability and survival. In fact, they often are more concerned with the stabilization of prices than the maximization of profits, and with firm survival rather than short-term returns (Fligstein 2001). This proposition may not accord with prevalent theories of firm behavior, but it depicts actual firm behavior more accurately. The goals of making profits and ensuring survival can be complementary, but they also can conflict. For example, firms may face choices between higher-risk strategies that maximize returns and lower-risk strategies that prioritize survival. In more extreme cases, firms may confront choices between maximizing returns to shareholders and preserving the firm as a coherent entity – when deciding whether to sell off core assets, for example. Firms vary considerably across time and space with regard to their preferences for profits versus stability depending on the institutional context, including informal practices as well as formal laws. American firms have tended to focus more on financial returns, for example, while Japanese firms have favored stability.

Let us then postulate that firms can achieve profits and stability via two strategies (see box below). They can seek: 1) to raise productivity (create wealth) and/or 2) to secure rents (extract wealth). Incumbent firms may prefer the latter because they may be vulnerable to challengers that develop a product or a technique that renders their competitive advantage obsolete (Fligstein 2001). They may seek to insulate themselves from this threat rather than to rely on their ability to outrun the competition. They may in fact prefer collusion to competition. As Adam Smith famously declared: “People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.” (Smith 1976, Vol. 1, 144). To put this differently, firms can focus on building a better widget or manipulating market governance to maximize stability and profits with the widget they already have. The former entails a positive-sum enterprise of increasing the pie; the latter constitutes a zero-sum enterprise of protecting or expanding the firm’s slice of a given pie. In practice, of course, firms do both. But they can gain security by ensuring that they will survive even if they cannot always produce the best widget at the best price. And they are best able to maximize profits if they are able to supplement any price or quality advantage they might have with the exercise of market power to deter, absorb, or impede competitors.

<table>
<thead>
<tr>
<th>The Inequality Snowball</th>
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<tbody>
<tr>
<td>1. Firms seek both stability and profits.</td>
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<td>2. Firms can pursue these goals by raising productivity and/or by extracting rents.</td>
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<td>3. Firms deploy political strategies, such as lobbying, and business strategies, such as collaboration and collusion, to extract rents.</td>
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<td>4. To the extent that firms succeed in these strategies, inequality increases because dominant firms, their owners, and their executives garner rents at the expense of other firms and stakeholders, such as workers and customers.</td>
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<td>5. Political and market power reinforce each other to produce a snowball effect.</td>
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<td>6. This pattern continues unless disrupted by war, land reform, or major tax, social policy, and/or regulatory reforms.</td>
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Firms pursue rent-extraction via two inter-related mechanisms. First, they lobby government to create laws and regulations to protect them from competition, stabilize prices, and secure profits. This might include trade protection, domestic regulation, subsidies, tax credits or other policies to moderate price competition. Second, firms employ business strategies to increase their rents. In fact, governments must regulate to ensure that firms compete and that markets function properly precisely because firms have this propensity.

For example, firms can structure their business relationships to moderate competition via long-term alliances, interlocking shareholding, or exclusive supply chains (Fligstein 2001). They can engage in anti-competitive practices, from exclusive dealing to outright collusion; they can use intellectual property strategically to stifle challengers; or they can pre-empt competition by buying out potential challengers. They can exploit their advantages in bargaining power to squeeze their workers, suppliers, borrowers, other business partners, and/ or customers. They can manipulate their boards of directors to increase executive pay. They can seek regulatory loopholes to evade compliance with regulations. Or they can engage in regulatory arbitrage, shifting productive activity or assets to more favorable jurisdictions.

Firms also hire lawyers and accountants to help them maximize returns, minimize tax payments, and protect and grow their assets. As Katharina Pistor puts it:

The majority of practicing attorneys continue to offer mostly basic legal advice for a fee; but the true masters of the code use their legal know-how, which they built over years of practice in exchanges with clients and their professional kin, to craft new capital and in this process often make new law from existing legal material. Their toolkit consists of the modules of the code: the rules of property and collateral law, the principles of trust, corporate, and bankruptcy law; and contract law, the most malleable of them all (Pistor 2019, 160).

Firms benefit from the expertise of their legal advisors and their ability to challenge and reshape legal interpretation. This advantage becomes “the mother of all subsidies” for the wealthy and powerful, increasing the political and economic gap between them and everyone else (Pistor 2019, 222).

This section has focused on firms because they play a particularly powerful role in shaping government policy, and their strategies beget the market concentration, higher prices, lower wages, and lower investment that contribute to inequality. As Piketty stresses, much of the increase in inequality in the United States is due to superstar firms and their superstar managers (Piketty 2017, 32-33, 331-2, 365-81). Moreover, many wealthy and powerful individuals rely on firm political and business strategies to preserve and increase their wealth. Yet individuals play a complementary role in the inequality snowball. They support political leaders who lower their taxes or facilitate their strategies to protect and build their wealth. They hire professionals, such as lawyers and accountants, to execute these strategies. And they are able to invest in private equity and other alternatives that deliver higher returns than those accessible by less wealthy individuals.

If we imagine a starting point such as the unique moment after World War II, when both economic and social inequalities were at a low point in many countries, then we can recognize that there would be a general propensity for these inequalities to grow over time – all else equal – as small inequalities of wealth and power reinforce each other. Corporations and individuals would leverage power to secure profits and stability, and wealth to exercise more power. And market
concentration and rent-seeking would undermine growth, thereby further boosting inequality (Stiglitz 2016, Baker 2016, Schwartz 2016, Boushey 2019). The accumulation of inequality would continue until something stops it. That something could be war or tax hikes, as Piketty notes, or land reform, or major regulatory shifts such as the U.S. New Deal (Piketty 2017, 27-8, 636-53).

**The Mechanisms of Influence**

Firms’ success in the political arena depends not only on their “instrumental power”: their advantage in financial and organizational resources. Firms and their executives also have “structural power” in that incumbent political leaders depend on business to support the performance of the economy to improve their chances for re-election (Culpepper 2015). They focus particularly on the most visible indicators, such as GDP growth and the stock market indexes. So politicians may be inclined to support policies that encourage firms to hire workers or to invest in plants, thereby contributing to economic performance overall (Lindblom 1977). In recent years, political leaders have been particularly keen to support policies that help the financial sector because this can support the stock market. The irony, of course, is that U.S. government efforts to support financial markets fostered many of the policies that fueled the global financial crisis. The structural power of finance also impeded an effective response, as the Barack Obama administration focused too much on bailing out Wall Street and too little on punishing bank executives and supporting individuals who lost their homes and/or confronted financial ruin (Johnson and Kwak 2010).

Large firms and wealthy individuals also benefit from social networks, social status, and ideological hegemony. They often share membership in elite networks of wealth and power that span from government to the private sector. They may participate in a revolving door whereby key leaders move back and forth between the two sectors. They also benefit from a kind of “cultural capture” in which government and private sector elites share basic assumptions, thus shaping policy options even in the absence of direct lobbying (Kwak 2014). They may exercise ideological influence in a more deliberate way, funding university programs and think tanks in order to shape the prevalent discourse. And of course they have disproportionate influence in politics.

Some of the most profound disparities in wealth, status, and power in the United States are grounded in racial and ethnic differences. The legacy of slavery has left deeply entrenched patterns of inequality in power and wealth between whites and African Americans. The United States has a long history of unequal treatment under the law beyond slavery, from the Jim Crow laws to voting restrictions and criminal justice. And these legal and regulatory barriers have been compounded by marketplace discrimination, from labor to finance to housing markets. Racial discrimination in hiring has reinforced occupational segregation and perpetuated the racial wage gap, which actually increased from 21.8% in 2000 to 27.5% in 2018 (Economic Policy Institute 2019). Likewise, gender discrimination has bolstered the gender wage gap, which has declined from 36% in 1980 to 15% in 2018 (Graf, Brown and Patten 2019). In financial markets, minority consumers have more trouble getting credit; they are more likely to fall victim to predatory lending; and the pay more for financial services overall (Taylor 2019). Minority business owners are less likely to apply for loans and more likely to be denied, and they pay higher interest rates when they do borrow. This disparity in financial access contributes to a stunning wealth gap: the median family wealth for African-Americans is $17,600 compared to $171,000 for white Americans (Lee 2019). Moreover, those who oppose policies to promote economic equality and opportunity, including public investment and social welfare policies, have leveraged race to make
their case, implying that benefits would go disproportionately to minorities who are lazy rather than structurally disadvantaged (Haney López 2014).

The following sections flesh out the general model sketched above by surveying developments in corporate governance, financial regulation, labor relations, antitrust, regulatory reform and intellectual property rights. These cases illustrate both the similarities and the differences among these issue-areas. All of them were profoundly influenced by the “neoliberal” turn that began in the late 1970s and accelerated in the early 1980s. The stagflation of the 1970s undermined the postwar mixed economy consensus and created the political space for a sustained assault on government management of the economy in general and market regulation in particular. Yet the ideology of free markets camouflaged policy changes that did not actually reduce government regulation but rather re-designed it to facilitate the pattern of rent-seeking outlined above. In all of the cases, industry incumbents pushed for legal and regulatory changes that shifted market power in their favor and took advantage of those changes once they were enacted, thereby increasing inequality (see Table 1 below). Nevertheless, there are substantial variations across the cases. Some reflected ideological shifts (antitrust) while others were driven by more direct lobbying efforts (finance). Some reflected purer forms of rent-seeking politics (California electricity deregulation), while others incorporated more public interest concerns (telecommunications). The following sections review how laws and regulations changed in each of these issue-areas, how firms took advantage of these changes, and how this exacerbated inequality in America.

Table 1. Market Governance and Market Power Relationships

<table>
<thead>
<tr>
<th>Issue Area</th>
<th>The Balance of Market Power</th>
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<tbody>
<tr>
<td>Corporate Governance</td>
<td>Shareholders (workers, citizens)</td>
</tr>
<tr>
<td>Financial Regulation</td>
<td>Financial institutions (borrowers, savers)</td>
</tr>
<tr>
<td>Labor Relations</td>
<td>Employers (employees, contract workers)</td>
</tr>
<tr>
<td>Antitrust</td>
<td>Incumbents (challengers, consumers)</td>
</tr>
<tr>
<td>Regulatory Reform</td>
<td>Incumbents (challengers, consumers)</td>
</tr>
<tr>
<td>Intellectual Property Rights</td>
<td>IPR owners (challengers, consumers)</td>
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Corporate Governance
The United States has shifted markedly since the 1980s toward a shareholder model of corporate governance in which corporations prioritize the goal of maximizing shareholder returns rather than serving the interests of a broader range of stakeholders. This has contributed to corporate strategies that favor shareholder returns over wages and investment. Corporations lobbied for many of the legal changes that propelled this shift; they pressed for the implementation of rules in their favor; and they leveraged regulatory arbitrage to move assets and business activity
into more favorable jurisdictions. And executives manipulated the structure of corporate boards and their personal relationships with board members to raise their own pay. Piketty estimates that 60-70% of those with income in top 0.1% in the United States in the 2000-10 period were corporate executives (Piketty 2017, 380). He stresses that the huge variations in executive pay across time and space cannot be explained simply by executive or firm performance. He attributes skyrocketing pay in the United States instead to the fact that top managers have been able to set their own compensation, and to social norms that permitted this (Piketty 2017, 32-3, 417-20). He is right that the U.S. corporate governance model is characterized by distinctive norms, but he misses how the transition since the 1980s has been driven by specific legal and regulatory battles.

The U.S. government moved earlier than other industrialized countries to transfer the burden of pensions from employers to employees, thereby broadening and expanding share ownership and fueling the shift toward the shareholder model. The government promoted a transition from defined-benefit pension plans to defined-contribution plans – such as Individual Retirement Accounts (IRAs) and 401(k) plans – by providing tax deductions for contributions. In 1974 Congress passed the Employment Retirement Income Security Act (ERISA), which introduced IRAs and increased corporations’ liability for paying out benefits from under-funded defined benefit plans, thus encouraging employers to switch to defined contribution plans. A 1978 amendment to the law then created 401(k) plans, allowing pension funds and insurance companies to invest large proportions of their portfolios in the stock market and thereby contributing to the rise of large and powerful institutional investors. Institutional investors pressed the government to strengthen requirements for independent directors and to raise standards for shareholder representation via proxy votes and participation in annual general meetings (Véron, Autret, and Galichon 2006, 136-9). And business groups lobbied to permit share buybacks and stock options, and to give favorable tax and accounting treatment for those options.

Corporations and financial institutions took advantage of these legal and regulatory changes. Investment banks cultivated new techniques for transferring corporate control such as the leveraged buyout (LBO), which enabled investors to purchase a company by borrowing against the company’s own assets. Institutional investors used their market power plus direct appeals to press companies to deliver higher returns. Corporate managers who wanted to retain control deployed strategies to boost the share price, including buying back shares, divesting divisions, and laying off workers. The shareholder model also motivated a transition toward “fair value” accounting, whereby financial assets were assessed at their market value rather than the original purchase price. Fair-value accounting hurt workers because it pressed managers to be more sensitive to short-term fluctuations in share prices, and therefore more aggressive in cutting labor costs (Véron, Autret, and Galichon 2006, 16-18, 89-91). Meanwhile, corporate lawyers devised increasingly complex structures to privilege certain asset owners over others, or to shift business risks to creditors, employees, or the general public (Pistor 51-67).

Proponents of the shareholder value model argued that that the sole legitimate purpose of a firm is to maximize shareholder value; that good managers should raise the firm’s share price; and that unsuccessful managers deserved to be ousted by the board. They believed that managers would more faithfully represent shareholder interests if their compensation were more closely tied to stock performance through stock options, for example, and their companies were more vulnerable to takeover (Jensen and Murphy 1990). But in practice compensation via stock options gave executives incentives to engage in speculation and manipulation at the expense of investments to foster innovation, boost employment, and promote long-term growth. Executives speculated by overstating the company’s performance and then exercising their options, and they...
manipulated the share price with stock repurchase programs (Lazonick 2014). Top executives stacked boards with friends and allies, and hired executive pay experts who fueled a competition in ever-higher pay packages (Bebchuck and Fried 2004).

U.S. executive compensation via stock options soared as the stock market boomed, most dramatically in the 1990s and 2000s. Chief executive officer compensation grew 1271 percent from 1978 to 2000, and 200 percent from 1995 to 2000 alone (Mishel and Davis 2015). The stock options and long-term incentive plan shares of CEO compensation grew from 7 and 19 percent, respectively, in the 1980s to 15 and 32 percent in the 1990s, and 23 and 37 percent 2000-05 (Frydman and Jenter 2010). The U.S. CEO-to-worker pay ratio stood at 265 in 2017, compared to 136 in Germany and 58 in Japan (Bloomberg News, 2017). The shift toward the shareholder model of corporate governance contributed not only to higher shareholder returns, but also to lower labor share and stagnant investment. Over the long run, these management practices impaired corporate performance and weakened the U.S. economy overall (Lazonick 2013).

**Financial Regulation**

U.S. financial reforms since the 1970s produced a financial sector characterized more by competition on price and less by reliance on relationships. They also facilitated financial innovation, propelled industry consolidation, and increased market volatility. The U.S. government liberalized deposit interest rates and stock commissions, broke down the Glass-Steagall regulatory barriers between commercial and investment banks, permitted interstate banking, and chose not to regulate derivative instruments directly. Financial institutions accelerated these legal and regulatory changes by challenging regulations in the marketplace and in court, and they took advantage of them after they passed. These developments fueled a sustained increase in the financial sector’s share of national income and a boom in financial executive salaries (Eichengreen 2015, 66-77).

The financial sector enjoyed a combination of financial resources, organizational power, and network ties to the government that enabled it to shape the regulatory regime. Government and financial sector elites were interpenetrated, with top Wall Street executives playing key roles in the Treasury Department and financial regulatory agencies. Political leaders relied on a strong economy, and the financial sector played a critical role in providing credit and fueling the stock market. The fragmentation of the U.S. financial regulatory regime not only required a high level of coordination among agencies, but it gave financial institutions the ability to engage in “regulatory arbitrage,” taking advantage of differences in regulation across different markets or jurisdictions to increase profits (Lavelle 2013, 7). Given the fragmentation of authority plus the more legalistic regulatory style, the U.S. approach to financial regulation was more post-hoc than ex ante. That is, financial institutions tested the limits, and then the regulators judged whether the institutions had violated a rule.

U.S. financial reforms began earlier and proceeded further than in other industrial countries. The SEC forced the stock exchange to liberalize commissions in 1975. Congress phased out deposit interest ceilings under the Depository Institutions Deregulatory and Monetary Control Act of 1980. It sought to strengthen the competitive position of savings and loans and other banks with the Garn-St. Germain Depository Institutions Act of 1982. This legislation liberalized the banks’ use of funds, which helped them to achieve higher returns with their investments. It permitted adjustable-rate mortgage loans, which moderated their risk exposure. And it authorized money market deposit and “super” NOW accounts, which helped them hold on to more of their depositors. By allowing the savings and loan institutions to take more risks without
strengthening regulation and supervision, the government set the stage for a crisis in the sector by the late 1980s. In 1994, the Clinton administration permitted interstate banking, fueling consolidation. The large commercial banks and investment banks aggressively lobbied Congress to repeal the Glass-Steagall Act outright, prevailing in 1999 with the Financial Services Modernization (Gramm-Leach-Bliley) Act, which allowed banks, securities firms, and insurance companies to forge financial conglomerates.

U.S. financial institutions consolidated into universal megabanks. They shifted more toward fee-based business strategies focused on the development of complex financial instruments and mergers and acquisitions. And they increased their leverage to take higher risks and earn high profits. Most major U.S. investment banks shifted from partnerships to publicly listed corporations in the 1980s. This meant that managers had less stake in the long-term health of the firm and more interest in the short-term maximization of profits, and this encouraged riskier behavior. It also opened up the possibility of compensating executives via stock options, which further promoted risk-taking.

The financial reforms of the 1980s and 1990s also set the stage for the global financial crisis. The government’s decision not to regulate derivatives opened the door for financial institutions to develop a market for mortgage-backed securities that broke the direct link between borrower and lender and enabled lenders to issue riskier mortgages and financial professionals to deploy them for speculation. The government relied heavily on self-regulation for high-net-worth traders and institutional investors, plus private sector monitors, including credit agencies, accountants, and financial analysts. Financial institutions increased their leverage to take higher risks and earn higher rents. They developed elaborate hedging strategies to mitigate risk, but this only led them to place bigger wagers and thereby to increase the system-wide risk. The run-up to the crisis thus highlighted legal and business strategies that favored rent-seeking by financial institutions over the welfare of financial consumers, especially homebuyers. The crisis dropped family income by 7.7 percent from 2007 to 2010, from $49,600 to $45,800. Unemployment surged from 5 percent in January 2008 to 10.2 percent in October 2009. At least 3.7 million homes were foreclosed between 2008 and 2012. And the number of families falling below the poverty line rose from 12.5 percent in 2007 to 15.1 percent in 2010 (Kelleher, Hall and Bradley 2012, 13-58). The crisis moderated income inequalities in the short run by destroying so much wealth, but the resolution of the crisis favored finance executives rather than homeowners, and enabled a relative rapid return to the pre-crisis pattern of inequality. Congress strengthened financial regulation with Dodd-Frank Bill Wall Street Reform and Consumer Protection Act in 2010, but the finance industry managed to fight off some measures and to pare back others after the fact.

Ultimately, the financial sector seized a growing share of the economy without delivering greater benefits to consumers. The cost of finance – in stark contrast to the cost of wholesale or retail trade, for example – increased despite advances in information technology (Philippon 2015). Thomas Philippon argues that the high cost of finance is due in part to increased trading activity, yet increased trading has not led to more informative stock prices or to improved risk sharing. Thus he estimates that the financial sector’s share of GDP is about two percentage points higher than it should be (Philippon 2012). Meanwhile, financial reforms have contributed to growing economic inequality, especially the enormous rise in the fortunes of the top 1 percent and the very top 0.1 percent of the most wealthy. Piketty estimates that 20% of those with income in top 0.1% in the United States in the 2000-10 period were financial professionals (Piketty 2017, 380).
Labor Relations

Corporate governance and financial reforms propelled soaring income at the high end of the U.S. labor market; but labor law and regulation help to explain the lack of substantial income increases for most other Americans. The decline of labor power and the labor share of income has been driven more by changes in the implementation of labor law and in labor practices than in changes in the law itself, at least at the federal level. Congress failed to pass measures to preserve union strength; national leaders took steps to undermine it; state governments passed laws hostile to labor; and employers increasingly deployed practices to discourage union organization (Wilensky 2012, 157-58). Union density decreased and firms grew more willing to lay off workers. The unions’ loss of leverage vis-à-vis employers was compounded by declining political power, and that contributed to policies that favored employers over workers (Hacker and Pierson 2010). Golden, Wallerstein and Lange (1999, 201, 221-5) find that only the United States and Britain – among a sample of twelve industrialized countries – experienced a dramatic decline in union influence in the 1980s and 1990s, and they suggest that government policy played an important role (see Table 2).

Table 2. Union Bargaining Coverage in Various Countries, 1970 versus 2017

<table>
<thead>
<tr>
<th>Country</th>
<th>1970</th>
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Source: OECD 2019.

The Reagan administration attacked union power by confronting public sector unions, facilitating corporate restructuring, and paring back labor protections. Reagan set the tone in 1981 by firing workers from the Professional Air Traffic Controllers Organization who went on strike. Bruce Western (1995, 187) argues that this helped to establish the union-free environment as a legitimate goal for employers, and demonstrated the feasibility of hiring replacement workers to break strikes. Western and Rosenfeld (2011) contend that union decline also eroded the moral economy of fair pay, contributing to greater inequality in wages. The administration appointed more business-friendly representatives to the National Labor Relations Board (NLRB), and enacted rule changes that made it easier for companies to decertify unions and harder for unions to win elections (Cohen 2000, 133-34; Western 1995, 186). Many states passed “right to work” laws that undercut union power by prohibiting mandatory union dues. Unions and their allies...
failed in several key efforts to pass labor reform due to Senate filibusters (Hacker and Pierson 2010, 128-32, 278-79). Supreme Court decisions also tilted the balance of power in favor of employers by supporting arbitration for labor disputes, ruling against the plaintiffs in some key discrimination cases, and rejecting mandatory union dues for public employees.

Employers grew increasingly combative in fighting union organization, and a growing corps of specialized consultants actively promoted anti-union philosophy and strategies (Levitt and Conrow 1993; Logan 2002). Union-avoidance tactics increased, reported violations of the National Labor Relations Act surged, and strike rates plummeted. American companies began large-scale downsizing of their workforce in the late 1970s, accelerating in the 1980s and 1990s. They initiated the trend during an economic downturn but continued through upturns to the point where better economic conditions in the 1990s actually correlated with more downsizing. The U.S. job loss rate reached 10 percent in the 1980s, and then 14 percent in the 1990s. Gregory Jackson calculates that U.S. firms were 3-4 times as likely as Japanese firms to have workforce reductions greater than 10 percent in the 1991 and 2001 periods (Jackson 2005, 424). The decline of union power, combined with the rise of the shareholder model, contributed to a long-term decline in labor compensation as a share of national income, from 62.6 percent in 1990 to 57.1 percent in 2018 (Bureau of Labor Statistics, 2019).

Meanwhile, firms increasingly outsourced both manufacturing and services, reducing their own employee base. This increased inequality between a small core of employees of the most profitable firms with high incomes and generous benefits, and a larger mass of workers elsewhere with lower compensation and less job stability (Schwartz 2016, 237-41). Firms dampened competition in labor markets with non-compete clauses in employment contracts, and used mandatory arbitration to limit damages in labor disputes. Firms in the gig economy such as Uber took advantage of the classification of their workers as contractors to avoid paying benefits (Collier, Dubal, and Carter 2018).

**Antitrust**

The shift in antitrust policy took the form of an ideological shift more than lobbying for specific policy changes, yet it still reflected the political forces underpinning the Reagan revolution. The proactive approach of U.S. antitrust policy in the 1950s and 1960s was increasingly challenged by the Chicago School in the 1970s and 1980s. Scholars in the Chicago School contended that monopolies tend to be fragile and competition robust because firms that attempt to charge monopoly prices were likely to be challenged by competitors over time. Moreover, the government might be incapable of devising an appropriate remedy, or it might be captured by political interests such as small businesses. Hence these scholars were reluctant to prescribe government action even when a firm dominates a market or engages in anti-competitive practices (Posner 1979, Hovenkamp 2005, 25-30). This transition in policy allowed a gradual consolidation of market power in many sectors. This in turn fueled the rise of powerful firms that garnered much higher returns than other companies and their “superstar” managers, which propelled income inequality. And market concentration enabled labor market monopsony, whereby firms did not have to compete so much to attract workers, so they could pay lower wages. Thomas Philippon argues that the decrease in competition in U.S. economy since the 1990s has led to higher price markups, higher after-tax profits, lower investment, lower productivity, a lower labor share of income, and higher inequality. He stresses, moreover, that the stakes are huge. He estimates that if the economy were as competitive as it was 20 years ago, GDP would be 5% higher, meaning $1.5 trillion more income for American workers. Hence strengthening antitrust would
deliver higher economic benefits than most any other proposed policy reform (Philippon 2019, 287-94).

Under the Reagan administration, the authorities shifted from defining competition by the number of competitors to economic analysis centered on consumer welfare: low prices, high output, and potential for innovation (Hovenkamp 2005, 2). The number of attorneys in the Antitrust Division dropped from 456 in 1981 to 229 in 1988 (Reback 2009, 163). The courts placed more procedural constraints on plaintiffs, and the number of antitrust cases dropped dramatically. William Baxter, the head of the Antitrust Division, dropped a major antitrust case against IBM, and issued guidelines to narrow the scope for merger case action. He did not take up cases against manufacturers for distribution practices, arguing that most of these agreements were designed to lower costs and few impeded competition. The Supreme Court review of antitrust cases declined under Chief Justice William Rehnquist (1986-2005), leaving conflicts among lower federal courts unresolved and errant or outdated judgments uncorrected (Hovenkamp 2005, 5-7). During this period the government gradually shifted toward the post-Chicago school, which preserved some of the Chicago School skepticism toward activist antitrust policy but recognized that anti-competitive practices could impose substantial consumer welfare costs in specific cases. Yet the government did not return to the aggressive pro-competitive stance of the 1960s.

Mergers boomed in the 1980s, including strategic acquisitions to strengthen core competencies and hostile takeovers designed to boost shareholder returns (Fligstein 2001, 147-69). John Kwoka contends that most mergers resulted in competitive harm, usually via higher prices. In many cases the harm was substantial, with post-merger price increases greater than 10 percent. And non-price effects tended to follow price effects: mergers that resulted in higher prices also undercut quality, quantity, and research and development. Kwoka also finds that policies intended to remedy mergers, such as divestiture and conduct remedies, did not restrain price increases. He concludes that the antitrust authorities have been much more likely to approve mergers that they should not have allowed than to disallow mergers they should have approved (Kwoka 2015, 153-60). A Council for Economic Advisors study found that market concentration increased in many core sectors from 1997 through 2012, with the largest increases in transportation, retail trade, finance and insurance, wholesale trade, real estate, and utilities (Council of Economic Advisers 2016, 4).

The antitrust regime faced particular challenges in information technology given the powerful network effects in that sector. Consumers want goods and services other users already have, and will pay more for those. So market leaders such as Microsoft and Google could eliminate competitors with superior products by leveraging these effects. Microsoft negotiated a contract with IBM that allowed it to license its MS-DOS operating system to IBM's competitors, thus breaking IBM's control over the value chain. Microsoft then deployed elaborate strategies to consolidate a dominant position, such as bundling its browser with its operating system. Under a 2001 settlement, Microsoft agreed to give computer manufacturers more freedom to install competing browsers and to share its application interface information, but it admitted no liability and retained the right to add other software features to its operating system (Reback 2009, 236-37).

The digital platform economy is particularly conducive to monopoly, with platform operators – such as Google, Amazon, Facebook and Apple – establishing dominant positions and setting the terms of competition on their platform (Kenney and Zysman 2016, Khan 2017). The FTC took on Google in 2011, investigating whether it leveraged its dominant position as a search engine, giving favorable treatment to its businesses and business partners in displaying Internet
search results. But the FTC found that Google’s practices had benefitted consumers and that any negative impact on competitors was incidental to that goal. Google made some minor concessions, agreeing not to include third-party content in specialized Google search results, and to license cellphone patents for critical standardized technology to competitors for devices such as smart phones, laptop computers, and game consoles. The European Commission imposed much stiffer conditions in its own tentative settlement in February 2014, forcing Google to give rivals more prominence in specialized search results. The big technology firms came under increasing scrutiny in the United States after the 2018 midterm elections, with reformers calling for a decisive shift in U.S. antitrust policy and enforcement. Congressional leaders held highly publicized hearings, and the Fair Trade Commission (FTC) and the Department of Justice Antitrust Division showed tentative signs of taking a tougher line.

**Regulatory Reform**

While U.S. antitrust policy shifted toward a more laissez-faire stance, regulatory reform moved in a more pro-competitive direction. The U.S. government launched the global “deregulation” movement in the mid 1970s, when Senator Edward Kennedy and others began to herald the cause in congressional hearings. The movement brought competition to monopoly and oligopolistic sectors, propelled a leap in the scope and complexity of economic regulation, and contributed to both the digital revolution and the global financial crisis. An unusual bipartisan coalition supported the regulatory reform movement, including academics, government officials, and business and consumer groups. Economists challenged the public interest rationale for regulation, arguing that policymakers should not assume that a market failure justifies government action but should carefully weigh the costs and benefits of regulation. And they charged that technological change and market dynamics had undermined the original rationale for regulation in many sectors. Regulatory reform did not take the form of deregulation in the literal sense, but rather pro-competitive regulation designed to enhance competition: freer markets with more rules (Vogel 1996). And in some cases industry lobbyists deployed the free market mantra as camouflage for efforts to shift regulation in favor of their interests.

Thus the distributive impact of regulatory reforms is more ambiguous than that of the other developments discussed above. In principle, pro-competitive regulation should shift firms from rent extraction to value creation, and this should reduce rents and raise consumer welfare. In practice, however, regulatory reform liberated firms to adopt more aggressive strategies that favor profits over wages, investment, and other public-interest goals such as universal access to service. The politics, business strategies, and the public welfare consequences varied considerably by sector.

Regulatory reform had the greatest welfare benefits in telecommunications. The breakup of AT&T accelerated the digital revolution by generating competition in telecommunications and thereby lowering transmission costs and driving innovation, and by creating a new class of aggressive information technology users in the form of the Baby Bells. The breakup of AT&T and subsequent regulation fostered competition that lowered communications costs, including flat-rate local service, which enabled venture firms to offer value-added services and household consumers to experiment with new applications at a reasonable cost. The 1996 Telecommunications Bill allowed regional bell operating companies, long-distance carriers, and cable television companies to enter each other’s lines of business. Proponents of the bill argued that it would promote “intermodal” competition (between telephone and cable companies, for example) and foster stable competition in the sector. In practice, however, the cable companies
and telephone companies entrenched their dominance on their own turf, and two companies (the dominant cable company and the dominant telephone carrier) came to control the market for broadband Internet services in most local markets. The United States wound up with higher prices and inferior service relative to most advanced countries (New America Foundation 2015).

California’s electricity reform, in contrast, offers the ultimate case of regulatory reform as rent-seeking. Enron and other trading firms pressed for a market design that would favor them in a supply shortage, and then shamelessly gamed the market after the reforms to boost profits even as consumers endured blackouts (O’Neill and Helman 2007, 143-47). The authorities began to explore options for market reform in the wake of the energy crises of the 1970s. But a flawed market design resulted in a major crisis in 2000-01, with extensive brownouts and blackouts, huge losses for taxpayers, and the bankruptcy of a major utility company. The California regulatory scheme froze the retail prices charged to consumers but not the wholesale prices paid to generators, leaving the electric companies vulnerable to wholesale price increases. The market was particularly vulnerable to manipulation because it was fragmented into geographical zones and it lacked efficient procedures to manage congestion. These features combined with a supply shortage to produce a full-fledged crisis. Other U.S. regional electricity markets have developed more successful market designs.

The airline sector provides a middle case, somewhere between the broader public benefits of telecommunications and the private rent extraction of California electricity. The Civil Aeronautics Board began to approve substantial discounts and to lower barriers to entry in the mid-1970s. Congress passed the Airline Deregulation Act in 1978, producing the closest thing to “deregulation” in the literal sense as it abandoned price and entry regulation, and this eventually led to the elimination of the Civil Aeronautics Board in 1984. U.S. airline reform brought reductions in prices, but it is tricky to sort out the welfare impact because prices were already coming down prior to reform. And the reforms brought lower service quality and reduced service for some smaller airports (Kahn 2002, 36-42). Moreover, the benefits from competition waxed and waned over the years as the industry structure transitioned from intense competition in the 1980s to oligopoly in the 2010s. Fifty-eight new carriers entered between 1978 and 1990, but only one of these remained by 2005. Carriers reorganized into a hub-and-spoke routing model, with the dominant carrier controlling more than half of traffic at many major hubs. Air travel prices have rebounded since 2009, and the sector has been dominated by four carriers since 2014.  

**Intellectual Property Rights**

U.S. patent protection has expanded in recent decades to cover software and business practices, while copyright protection has been extended in duration. The U.S. intellectual property rights (IPR) regime has contributed to growing inequality by enabling firms that enjoy the benefits of IPR protection to increase their profits and salaries for managers and core workers at the expense of other firms, consumers, and workers. Patents, copyrights, and trademarks are meant to provide an incentive for innovation, but they are also anti-competitive because they grant a monopoly. The government determines the excludability of intellectual property, so the specific terms affect everything from profits to wages, investment, and economic growth (Schwartz 2016, 237).

The U.S. firms with the highest level of profits are concentrated in those sectors characterized by a high reliance on IPR, especially pharmaceuticals and high technology. These firms tend to reduce their labor footprint by outsourcing and offshoring. They share some of their rents with top managers and core workers but not with a wider and more diverse range of workers. And they are better positioned to shift profits to low-tax venues because they rely heavily on
intangible assets. The IPR regime has contributed to the polarization of the economy, with high-profit firms with IPR that share their rents with a relatively small core of workers, and a broader sector in more competitive industries that tend to squeeze their workers with lower wages and less favorable work conditions (Schwartz 2016, 228-237).

The U.S. intellectual property rights regime has transformed since 1980 as the government has extended patent protection to new actors, such as universities, and new products, such as software and business methods. This has created a booming secondary market for patents, yet it has in turn created problems that have undermined patent protection’s core goal of promoting innovation, including the patent “thicket” and “troll” phenomena. The Bayh-Dole Act of 1980 authorized the granting of patents for the results of publicly funded research and permitted universities and public laboratories to sell exclusive licenses to private firms or to set up joint-ventures with these firms to exploit their intellectual property. Many universities soon mobilized technology transfer offices to sell patents to third parties (Coriat and Weinstein 2012, 281-2). In the 1980s the U.S. Patent Office began to issue patents for computer software, which had been considered unpatentable as mathematical algorithms that do not qualify as human inventions. In 1982, Congress established a Court of Appeals for the Federal Circuit (CAFC), commonly known as the Federal Circuit, for patent cases, and in 1998 the CAFC ruled that methods of doing business would be patentable as well. The Patent Office was subsequently inundated with applications for patents for computer software and business methods.

As patents proliferated they began to produce a “patent thicket”: a dense web of patent rights that companies must hack through to commercialize new technology (Shapiro 2000). Companies stockpiled patents for strategic purposes, including generating litigation revenues, defending against litigation threats, and trading patents. And non-practicing entities – companies that do not have their own inventions but make a business in patents, commonly referred to as “trolls” – bought up huge numbers of patents (largely for software), searched for possible infringements, and demand financial settlements or seek judgments through litigation. In the process, they impeded the development of new products, increased costs for businesses and consumers, and clogged the judicial system (Rader, Chien, and Hricik 2013).

The digital revolution has also transformed copyright policy, prompting battles between copyright holders and users. The cost of producing works had served as a major impediment to copyright infringement in the past, but digital technology made reproduction much easier and less costly, essentially costless in the case of copying computer files. This generated conflicts between content producers that sought maximum copyright protection and content users and Internet firms that wanted the freedom to copy and share content. The media industry lobbied for higher penalties for copyright protection and longer terms of protection.

Software presents distinctive challenges to copyright law because software programs can easily combine industry standards, such as menu commands, with more proprietary content, and this leaves the courts with the delicate task of determining what constitutes reasonable use of industry standards (Reback 2009, 101-38). Some software developers believe that software should be nonproprietary, and they have forged an influential open-source movement. Under the 1976 Copyright Act, the U.S. Congress specifically excluded ideas, processes, procedures, systems, and methods of operation from copyright protection. A special commission took up the thorny question of whether computer programs should be protected, recommending protection for the text of a computer program but not to the processes embodied in the program, and this approach was adopted in an amendment to the 1976 law that passed in 1980.
The U.S. extended copyright protection from 50 to 70 years after an author’s death under the Sonny Bono Copyright Term Extension Act of 1998, and it even applied this extension retroactively. This extension defies justification in terms of the core rationale of copyright protection, because authors are not likely to be motivated by the extra twenty years, and certainly not by retroactive extension. The 1998 Digital Millennium Copyright Act (DMCA) gave copyright holders new remedies for potential violations, such as the right to issue “takedown” notices that order violators to remove content from the Internet without resorting to costly and time-consuming lawsuits. The law made it illegal to break a copy protection algorithm or other electronic lock on a protected good, or even (with a few exceptions) to build a software tool that would enable such circumvention (Weber 2006, 221). Critics contended that this went too far because it allowed content producers to limit dissemination by technological fiat through encryption rather than relying on legal standards, such as the fair use doctrine (Kemp 2006).

The United States in Comparative Perspective

These case studies demonstrate how political and market strategies have combined to accelerate the inequality snowball since 1980. The framework presented here stresses that the accumulation of inequality is not a universal law of capitalism, but rather that it varies depending on the specific features of political and market institutions. This makes it particularly amenable to comparative analysis. For example, the more corporatist political systems of Northern Europe feature more equitable incorporation of capital and labor in policy formulation than the United States, forcing the two sides to compromise and encouraging them to work out mutually beneficial solutions to policy trade-offs (Wilensky 2002 and 2012). In Japan, the political parties are less clearly divided between capital and labor, with the center-right Liberal Democratic Party (LDP) more focused on equitable distribution and redistribution than the Republican Party in the United States. Japan has a more consensual policy process in which big businesses have to compromise with labor, agricultural, or small business interests (Vogel 2006, 2018, 2019). In contrast, more winner-take-all political systems like the United States and Britain are more conducive to capital-friendly solutions when the Republicans and Conservatives are in power, as has been the case for much of the period since the 1980s (Hacker and Pierson 2010). Similarly, the rate of acceleration or deceleration of inequality may vary depending on the degree to which political, economic, and social imbalances of power reinforce each other.

Likewise, cross-national research could shed further light on how market institutions shape firm policy preferences and business practices, thereby affecting the inequality snowball. For example, U.S. firms give higher priority to shareholder returns relative to Japanese firms, and lower priority to employment security. They are more likely to lobby the government for policies to help them cut labor costs, and less likely to demand policies that support labor-management collaboration (Vogel 2018, 43-116). They also have less developed channels for labor to exercise its voice in corporate strategy and more elaborate mechanisms to boost executive pay. The prevalent ideology in the United States dictates that managers have a duty to shareholders, whereas Japanese values stress the loyalty between firms and their workers. All of these factors help to explain why income inequality has risen more steeply in the United States than in Japan since 1980, but more fine-grained comparisons could sort out the relative impact of the various factors.

Following the logic of the argument presented here, moderating inequality will require major political, legal, and regulatory reforms. There is no pristine free market, only real-world markets thoroughly sullied by collusion, fraud, and imbalances of power. So the government should not be shy about recalibrating the rules. We could think of this as restoring a market
equilibrium, but that would not be true to the spirit of the argument here, for there is no equilibrium. If we imagine the core relationships of the economy – such as employer and worker, or producer and consumer – there is only a spectrum of power balances, as illustrated in Table 1. Market governance could shift them in one direction or the other.

For example, the U.S. government could shift the corporate governance system from one that favors shareholders to one that serves a broader community of stakeholders by imposing a federal charter for large corporations that requires them to include labor representatives on their boards and to address public interest goals. It could shift the financial system from enriching financial institutions and finance executives toward serving the broader public of financial consumers by enforcing the fiduciary rule, imposing a financial transaction tax, and strengthening consumer protection. It could shift the balance of power between employers and workers by lowering the hurdles for union formation, and prohibiting non-compete clauses and mandatory arbitration for labor disputes. It could reduce rents for incumbent firms and foster more innovation, lower prices, and high wages by strengthening antitrust enforcement and bolstering pro-competitive regulations in specific sectors, such as telecommunications and electricity. And it could shift the power balance between intellectual property owners and consumers by narrowing the scope and reducing the duration of IPR protection.

This argument does not in any way preclude other measures to address inequality, such as tax policy and welfare spending. Yet in some ways the marketcraft agenda is more foundational because it strives to restructure capitalism rather than to compensate society for some social costs. It resembles public investment (in education, for example) in that it is not aimed at redistribution after the fact, but rather at shaping the distribution of opportunities and rewards in the first place. And it involves less stark trade-offs. It offers the promise of growth with equity. It is pro-growth in that it should produce a more efficient allocation of income and wealth by eliminating distortions that favor the powerful and the wealthy, and by increasing the purchasing power of the lower and middle classes. It simply proposes to give workers the income they are due and consumers greater value for their dollar.
The author thanks Maurice Ang, Jake Brugger, Jonathan Hofer, and Amanda Zhao for superb research assistance; Robert Fannion, Neil Fligstein, Chase Foster, Amy Kapczynski, Darien Shanske, Jay Varellas and other workshop participants for valuable comments on an earlier draft; and the Il Han New Chair at the University of Berkeley for research funding.

The case studies in this article build on Vogel 2018, 51-76.

Ultimately, however, Piketty (2017, 655-9) contends that the drop in tax rates drove the boom in salaries, as managers pressed for higher salaries because tax rates were no longer confiscatory. I would argue that the policy changes and the business practices outlined here provide a more persuasive explanation for this shift.


U.S.-style private sector innovation in derivative instruments would have been impossible in Japan, because financial institutions could not have introduced new instruments without consulting the authorities in advance. In fact, the Japanese authorities’ operating principle was precisely the opposite: they prohibited everything not expressly permitted, the “positive list” approach, rather than allowing everything not expressly forbidden, the “negative list” approach (Litt et al. 1990).

This section builds on Vogel 1996, 223-28; and Vogel 2006; 66-68.

Philippon calculates the unit cost of financial intermediation as the ratio of the income of financial intermediaries to the quantity of intermediated assets.

The authors (2011, 514) estimate that union decline explains one third of the increase in wage inequality for men and one fifth for women from 1973 to 2007.

Dau-Schmidt et al. (2000) report 161 Department of Justice antitrust cases 1975-79; 127 cases 1980-84; and 83 cases 1985-89.

This scoring is based on the revenue share earned by the top 10 largest firms in the sector. The study also notes other trends suggestive of decreased competition: increased rents accruing to a few firms, lower levels of firm entry, and reduced labor mobility.

Google had 92 percent search engine market share worldwide as of August 2019 (Statcounter, 2019).

Shi-Ling Hsu (2015) argues that U.S. legal rules and institutions have driven economic inequality due to an inherent bias toward increasing the returns to capital over economic growth for all. Hsu cites several specific examples to drive home this point: financial regulation, not surprisingly, but also oil and gas subsidies, grandfathering (regulatory relief for incumbents), and electric utility regulation.

U.S. market share for 2019 according to IBISWorld (2019): Delta 22.7 percent, American 21.1 percent, United 18.5 percent, Southwest 15.2 percent.

Non-practicing entities’ share of all patent lawsuits in the United States increased from 20 percent in 2006 to 67 percent in 2013 (Scott Morton and Shapiro 2014, 466).

Hovenkamp (2005, 250-52) argues that copyright policy is particularly vulnerable to political capture.
REFERENCES


