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## The Regulatory Roots of Inequality in America

*Abstract:* Why has US income inequality surged to unprecedented heights since the 1970s? The rise in inequality was not simply the natural result of differential rates of return but was powerfully driven 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 shaped market governance in their own favor and then took advantage of that favorable governance in the marketplace. This “inequality snowball” was particularly pronounced in the United States because firms were more aggressive in their business and political strategies and because the political system delivered more winner-take-all policy outcomes than the more consensual political systems of continental Europe and Japan.

*Keywords:* Inequality, regulation, deregulation, market governance, market power, firm preferences, corporate governance

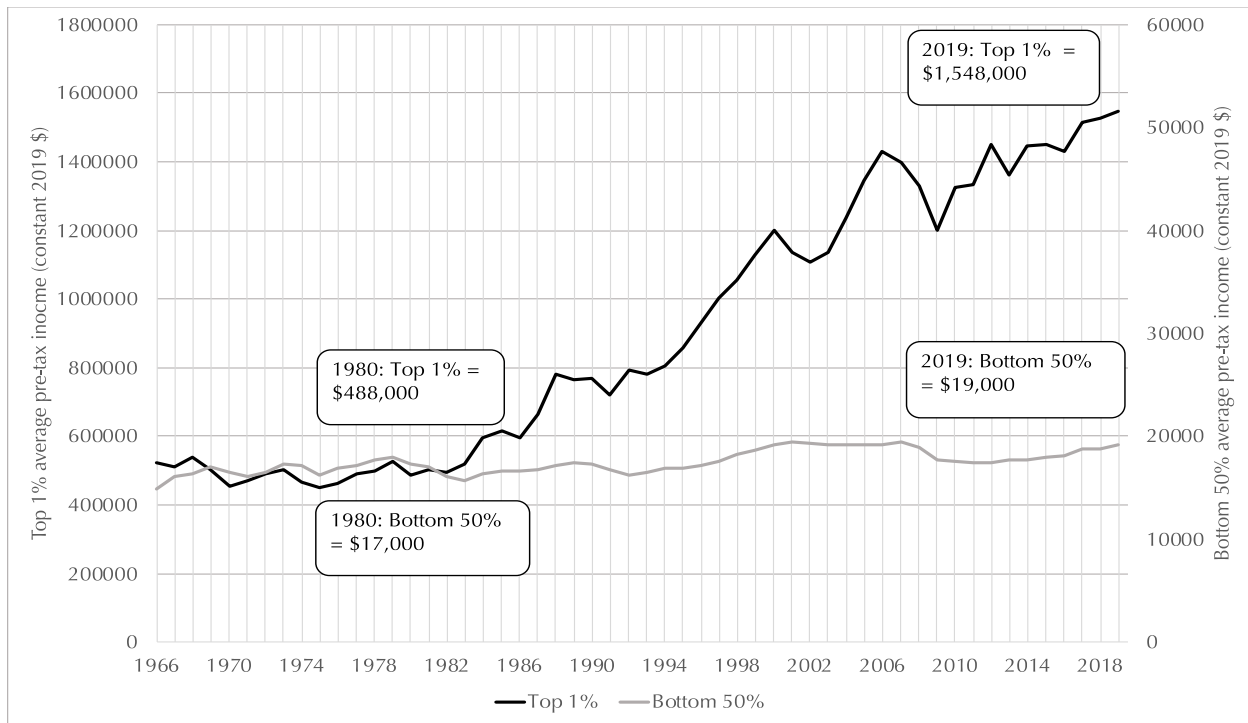
### I. The Marketcraft of Inequality

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 US surge is unprecedented in that it is driven more by inequality of wage income than by inequality of capital income (Piketty 2014, 374–81).<sup>1</sup> 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 systems (Atkinson 2015, 9–14; Boushey 2019, 194–5). US 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 one percent (see Figure 1).

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<sup>1</sup> Piketty (2014, 374–81) stresses that soaring compensation for superstar managers has boosted wage inequality.

**Figure 1. Pre-Tax Income of the Top 1% and the Bottom 50% of US Income Earners**

Source: World Inequality Database (2020).

Market governance is not the sole cause of inequality, but it is pivotal to the core dynamic of the accumulation of inequality (the “inequality snowball”), especially in the United States since the 1970s. Market governance refers to the formal laws and regulations, informal business practices, and social norms that structure markets. It includes everything from corporate governance to financial regulation, labor regulation, antitrust, and intellectual property rights (Vogel 2018a, 9–14). I refer to this as “marketcraft” because it constitutes a core function of government roughly comparable to statecraft. Government activity of this kind is not artificial intervention into a natural market but 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.<sup>2</sup>







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 to compete for jobs due to labor regulations and racial and gender discrimination, and firms are denied opportunities to compete for business due to lax antitrust rules and anti-competitive practices.

The government plays a critical role in promoting or constraining inequality by setting the terms of market competition. The core relationships in a market economy—such as those between employers

<sup>2</sup> This argument fits within the “market-institutional” tradition associated with Karl Polanyi (1944), which is well represented in the political economy subfields of various social science disciplines, and contrasts with the market liberal or “neoliberal” perspective (Barma and Vogel 2008, 1–18).

and workers, borrowers and lenders, and producers and consumers—are relationships of power (Fligstein 2001, 15–20).<sup>3</sup> 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, risk allocation, and prices (Table 1). 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 should produce a more equitable *and* more productive market economy in the United States.

**Table 1. Market Governance and Market Power Relationships**

Issue Area	The Balance of Market Power	
Corporate Governance	Shareholders	 Stakeholders (workers, citizens)
Financial Regulation	Financial institutions	 Financial consumers (borrowers, savers)
Labor Relations	Employers	 Employees, contract workers
Antitrust	Incumbents	 Challengers, consumers
Regulatory Reform	Incumbents	 Challengers, consumers
Intellectual Property Rights	IP owners	 IP users (challengers, consumers)

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 (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

<sup>3</sup> I define “power” here broadly to include bargaining power, political influence, and social status. All of these forms of power can affect market outcomes.

is cheaper, or they can outsource services to staff centers abroad. And imports from countries with lower labor costs undercut employment opportunities for lower-skill workers in the industrial countries (Acemoglu et al. 2015). 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, 2014, 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 advanced industrial countries since the 1970s because these 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 US 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 agribusiness firms. And as stressed above, it engaged in marketcraft that systematically favored the wealthy and powerful over everyone else.

Thomas Piketty (2014) documents 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 (ibid., 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 (Figure 2). Piketty enhances our understanding of inequality because he generates and analyzes new historical data, and he differentiates several epochs of inequality. He also identifies national variations within the broader trends he observes, stressing that the US rise in income inequality over the past few decades exceeds that of other countries by a substantial margin (Piketty 2014, 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.<sup>4</sup> 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

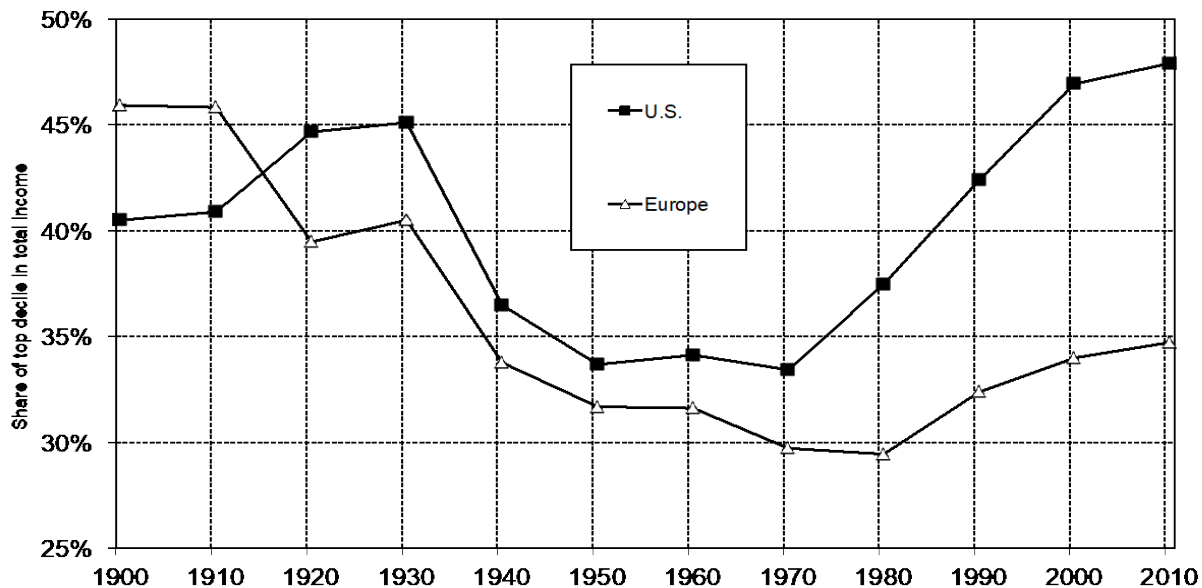
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<sup>4</sup> Piketty (2020) integrates politics and institutions into the analysis of variation in inequality over time more than Piketty (2014), but attributes causal primacy to ideology. Piketty (2020) also pays greater attention to market governance as a driver of inequality, especially corporate governance and labor relations.

marketplace, and that drives the accumulation of inequality, with varying success over time and across space.<sup>5</sup>

Piketty's differentiation between labor income and capital income and his delineation of historical periods are 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 labor income inequality in the United States since the 1970s than they are to explaining the rise in capital income inequality from the mid-nineteenth century through the early twentieth century. Piketty's focus on the basic logic of  $r > g$  hinges on capital income, as high returns to capital relative to economic growth tend to produce higher inequality of wealth over time. Nevertheless, market governance also affects the inequality of wealth because profits and wages are the sources of the wealth that is then compounded over time via investment. The regulatory structures of the late nineteenth century enabled market concentration and outsized 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, 114–41; Philippon 2019, 13–6, 18–20, 62–79).

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



Source: Piketty 2014, 409.

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

<sup>5</sup> Naidu (2017) offers a useful way to think about this distinction. He notes that wealth inequality can be represented as (1) the ratio of wealth to annual income or (2) the ratio of the bargaining power of owners to the profit rate. But the former conceptualization makes the rise in inequality appear relatively automatic, while the latter highlights how it is the product of politics and institutions (market governance). Moreover, it suggests a much broader range of policy remedies that focus on market governance, consistent with the argument presented here, rather than a narrower focus on tax policy.

capital to produce more with less labor, generating a growing reserve supply of labor. So, wages continuously fall over time (Marx 1977 [1847]). 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 time and space 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. His understanding of market exploitation is both too universal, in that it does not account for variation, 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 reverse this snowball effect. Hence capitalism can only be reformed effectively by transforming the market governance that defines the power relationships in the economy.

## II. The Inequality Snowball

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 the 1970s (Schwartz 2016, 228). Furman and Orszag (2015) argue that inequality is driven more by the increased dispersion of earnings *between* firms rather than *within* firms, and as Piketty stresses, much of the increase in inequality in the United States is due to superstar firms and their superstar managers (Piketty 2014, 32–33, 331–2, 365–81). 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, 17–18, 28–35). 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 (Table 2). They can seek: (1) to raise productivity (create wealth) and/or (2) to secure rents (extract wealth).<sup>6</sup>

Incumbent firms may prefer to secure rents because they may be vulnerable to challengers that develop a product or a technique that renders their competitive advantage obsolete (Fligstein 2001, 17-18, 28–35). 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 [1776], 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. 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 2. The Inequality Snowball**

1. Firms seek both stability and profits.
2. Firms can pursue these goals by raising productivity and/or by extracting rents.
3. Firms deploy political strategies, such as lobbying, and business strategies, such as collaboration and collusion, to extract rents.
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.
5. Political and market power reinforce each other to produce a snowball effect.
6. This pattern continues unless disrupted by war; land reform; or major tax, social policy, and/or regulatory reforms.

Firms pursue rent extraction via two interrelated mechanisms. First, they deploy political strategies, lobbying government to create laws and regulations to protect them from competition, stabilize prices, and secure profits. This might include market governance, trade protection, subsidies, or tax credits. Firms rely heavily on their “instrumental power,” their advantage in financial and organizational resources. But they also benefit from “structural power” because incumbent political leaders depend

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<sup>6</sup> There is no single measure of rents (returns in excess of value created), but several indicators suggest an increase in rents in the United States since the 1970s, including a rise in market concentration and a decline in market entry. In addition, corporate profits, markups, inequality in profits across firms, and Tobin’s  $q$  have increased over this period. Tobin’s  $q$  is the ratio between a firm’s overall market value and the replacement value of its tangible assets. So, a rise in Tobin’s  $q$  means a rise in the value of intangible assets, which could reflect brand value or intellectual capital, but could also reflect rents from government protection or exclusionary business practices (Lindsey and Teles 2017, 18–24 and Philippon 2019, 67–71, 93–4).



on business to support the performance of the economy to improve their chances for re-election (Culpepper 2015). These leaders focus particularly on the most visible indicators, such as GDP growth and the stock market indexes. So, they 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, 170–213). In recent years, political leaders have been particularly keen to support policies that help the financial sector because this can bolster the stock market.

Second, firms employ business strategies to increase their rents. For example, they can structure their business relationships to moderate competition via long-term alliances, interlocking shareholding, or exclusive supply chains. They can exploit their advantages in bargaining power to squeeze their workers, suppliers, borrowers, other business partners, and/or customers. Executives can manipulate their boards of directors to increase their pay at the expense of shareholders and other stakeholders. 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 preempt competition by buying out potential challengers. 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 (2019, 160).

Dominant firms' ability to challenge and reshape legal interpretation becomes "the mother of all subsidies," increasing the political and economic gap between them and everyone else (*ibid.*, 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. 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.

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 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). And they may exercise ideological influence in a more deliberate way, funding think tanks to shape the prevalent discourse.

Inequalities tend to grow over time—all else being equal—as small advantages of wealth and power reinforce each other. Corporations and individuals leverage power to secure profits, stability, and

wealth to exercise more power. And market concentration and rent-seeking undermine growth, thereby further boosting inequality (Stiglitz 2016; Baker 2016; Schwartz 2016; Boushey 2019). The accumulation of inequality continues until something stops it. That something could be war, tax hikes, land reform, or major regulatory shifts such as the New Deal (Piketty 2014, 27–8, 636–53).

### III. The United States in Comparative Perspective

This brings us back to the original question: Why has this inequality snowball been particularly pronounced in the United States since the 1970s? For one thing, the “neoliberal” turn that began in the late 1970s and accelerated in the early 1980s was sharper in the United States (and Britain) than in most other rich countries. During the golden age of the mixed economy from the 1950s through the 1970s, political leaders from both major parties largely agreed that the government should play an active role in the economy, managing business cycles and providing welfare services, and this approach delivered relatively equitable growth. Yet the oil shocks produced stagflation that undermined the postwar Keynesian consensus, and President Jimmy Carter (1977–81) was widely perceived to have failed in managing the economy. This created the space for President Ronald Reagan (1981–89) to take a radical turn toward a neoliberal agenda of tax cuts, privatization, deregulation, and containment of the welfare state.<sup>7</sup>

Reagan’s rise to power also marked the ascent of a neoliberal ideology that advocated less government intervention and more market freedom—as if the two were necessarily associated. Neoliberal thinkers like Milton Friedman regarded the market as an arena of freedom (voluntary exchange) and government regulation as a constraint on that freedom. Yet free-market ideology camouflaged policies that did not actually reduce government regulation but rather redirected it in favor of those with wealth and power in line with the pattern of rent-seeking outlined in the previous section.

The US case is distinctive in a comparative context in at least three ways that accelerated the inequality snowball: business policy preferences, political structure, and business strategies.<sup>8</sup> With regard to policy preferences, firms in liberal market economies like the United States and Britain competed more on the basis of cost and less on quality than firms in coordinated market economies like Germany and Japan. So, they were more likely to advocate market policies designed to lower costs such as financial liberalization, labor deregulation, or regulatory reforms in transport and utility sectors. And because they relied less on coordination with other firms or the government, they were less inclined to advocate policies to cultivate, preserve, or strengthen institutions that foster such coordination, such as giving labor more voice in firms or strengthening welfare policies (King and Wood 1999).

With regard to political structure, these policy preferences were mediated through a more winner-take-all political system conducive to capital-friendly solutions, especially when the Republicans were in power (Hacker and Pierson 2010). Moreover, the US business lobby presence grew dramatically after the 1970s, while countervailing powers such as labor organizations and public interest groups could not keep up (Drutman 2015, 8–15). In contrast, the corporatist political systems of Northern

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<sup>7</sup> While the sharpest break came with Reagan’s election in 1981, some of the key political and economic shifts from the postwar consensus to the neoliberal era, and from equitable growth to higher inequality, actually began in the 1970s (Hacker and Pierson 2010, 95–115).

<sup>8</sup> A detailed presentation of the comparative cases is beyond the scope of this article, but this brief characterization of the distinctive features of the US political economy builds on the author’s past comparative studies with Britain, Japan, Germany, and France (Vogel 1996, 2006, 2018a).

Europe featured more balanced incorporation of capital and labor in policy formulation, encouraging the two sides to compromise and to work out mutually beneficial solutions to policy trade-offs (Wilensky 2002 and 2012). In Japan, the political parties were less clearly divided between capital and labor, with the center-right Liberal Democratic Party (LDP) more focused on equitable distribution and redistribution than the US Republican Party. Japan also had a more consensual policy process in which big businesses forged compromises with labor, agricultural, and small business interests (Vogel 2006, 2018a, 2018b).

And with regard to business strategy, US firms challenged the prevalent market governance regimes more aggressively than their counterparts in Western Europe and Japan in ways that favored capital over labor and incumbents over challengers. American firms opportunistically boosted executive pay, devised new financial instruments, and deployed anti-union tactics, as described in the sections that follow. They were only able to do so because of the US model of “adversarial legalism,” with a more codified and legalistic regulatory regime (Kagan 2003). In Japan’s more discretionary system, private actors did not try to outmaneuver the system because they understood that they had to comply with the spirit and not the letter of the rules, and they risked being sanctioned if they defied the authorities’ intent. American managers were also less constrained by labor incorporation within firms, or by norms of equity with workers.

Finally, the United States’ history of slavery and its enduring legacy also propelled the inequality snowball. While a broader assessment of the relationship between race and economic inequality is beyond the scope of this paper, it is essential nonetheless to identify how race intersects with specific elements of the argument presented here. Racial inequity has accelerated the surge in economic inequality in the United States since the 1970s via both the political and the business strategy channels of the inequality snowball model. In politics, the Republican party has used a “dog whistle” strategy to leverage racism to win elections while pursuing policies, such as cuts in taxes and welfare spending and market governance reforms, which benefited the wealthy and powerful. They undercut support for public investment and social welfare policies by implying that these policies would benefit minorities who are lazy, not structurally disadvantaged. As Ian Haney López (2014, 3) poignantly concludes: “Race constitutes the dark magic by which middle-class voters have been convinced to turn government over to the wildly affluent, notwithstanding the harm this does to themselves.”

As for business strategy, market-liberal economists like Milton Friedman claim that racial discrimination is self-defeating since it means that employers restrict their pool of workers or lenders narrow their client base (Baradaran 2017, 210–11). But this conveniently ignores how discrimination fuels extractive business strategies. In finance, for example, banks have not simply excluded minorities by denying them access to capital via “redlining” and other discriminatory practices (Rothstein 2017). They have also actively preyed upon those minorities via payday lenders that charge exorbitant fees and interest rates. This strategy exploded with the subprime mortgage crisis, when banks actively sought borrowers in minority communities so that they could designate loans as subprime, and thereby charge higher interest rates and garner higher returns (Baradaran 2017, 234–40, 255–60). Discriminatory policies and practices mean that minority consumers have more trouble getting credit; they are more likely to fall victim to predatory lending; and they pay more for financial services overall. And 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 has contributed to a large and growing wealth gap. The median family wealth for African Americans was \$67,270 versus \$324,058 for whites (21%) in 1983, and \$139,523 versus \$919,336 for whites (15%) in 2016 (Urban Institute 2017).

Likewise, racial discrimination in hiring enables extractive business strategies that provide lower wages, benefits, and security to minority workers. This contributes to the low-road strategy of many US businesses that favors cutting costs over enhancing value (Wilensky 2012, 155–90). This reinforces occupational segregation and perpetuates the racial wage gap. African Americans (and women) are disproportionately concentrated in low-wage occupations, primarily in retail, food service, and home health care (Stiglitz 2016, 85). And a considerable body of research has confirmed that employers continue to discriminate on the basis of race (Bertrand and Mullainathan 2004; Pager, Western, and Bonikowski 2009). The black-white wage gap increased from 22.9% in 1980 to 31.0% in 2015 for men, and from 5.6% to 19.0% for women. The gap grew in the early 1980s due to rising unemployment, declining unionization, the failure to raise the minimum wage, and lax enforcement of anti-discrimination laws. The gap shrank in the late 1990s due to tighter labor markets and increases in the minimum wage, and then it continued to increase after 2000 (Wilson and Rodgers 2016).<sup>9</sup>

The following sections flesh out the model sketched above by surveying developments in the United States since the 1970s 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. 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. Nevertheless, there are substantial variations across the cases. Some were more strongly influenced by ideological shifts (antitrust) while others were more driven by direct lobbying efforts (finance). Some reflected purer forms of rent-seeking politics (California electricity deregulation), while others addressed public-interest concerns as well (telecommunications). Each section reviews how laws and regulations changed in that particular issue area, how firms took advantage of these changes, and how that exacerbated inequality in America.<sup>10</sup>

#### IV. Corporate Governance

The United States has shifted markedly since the 1970s 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 boost share prices and executive compensation 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 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 2014, 32–3, 417–20).<sup>11</sup> Piketty is right that the US corporate governance model is characterized by distinctive norms, but he misses how the transition since the 1970s has been driven by specific legal and regulatory battles.

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<sup>9</sup> Gender discrimination also accelerates the inequality snowball, but in different ways. For example, gendered inheritance practices affect the transfer of wealth across generations by concentrating the transfer on sons. The impact on households has increased with the rise in single-mother households and assortative mating (Boushey 2017).

<sup>10</sup> The case studies in this article build on Vogel 2018a, 51–76.

<sup>11</sup> Ultimately, however, Piketty (2014, 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.

The US financial sector lobbied the government 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. Corporate managers deployed strategies to boost share prices, including buying back shares, divesting divisions, and laying off workers. Institutional investors used their market power plus direct appeals to push companies to deliver higher returns. Corporate accountants transitioned toward “fair value” accounting, whereby financial assets were assessed at their market value (Véron, Autret, and Galichon 2006, 88–91). This 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. And 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 2019, 51–67).

Proponents of the shareholder value model argued 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 deserve 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 if 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 in employment, innovation, and 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).

US executive compensation via stock options soared as the stock market boomed, most dramatically in the 1990s and 2000s. Piketty (2014, 380) estimates that 60-70% of those with income in the top 0.1% in the United States in the 2000-10 period were corporate executives. And Bakija, Cole, and Heim (2012) find that compensation for executives plus financial professionals accounted for 70% of the increase in the share of national income going to the top 0.1% from 1979 to 2005. Chief executive officer compensation grew 1,271% from 1978 to 2000, and 200% from 1995 to 2000 alone (Mishel and Davis 2015). The stock option and long-term incentive plan shares of CEO compensation grew from 7% and 19%, respectively, in the 1980s to 15% and 32% in the 1990s, and 23% and 37% from 2000-05 (Frydman and Jenter 2010). The US CEO-to-worker pay ratio (on an options-realized basis) rose from 20:1 in 1965 to 58:1 in 1989 and 278:1 in 2018 (Mishel and Wolfe 2019). 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 (Gutiérrez and Philippon 2017). Over the long run, these management practices impaired corporate performance and weakened the US economy overall (Lazonick 2013).<sup>12</sup>

## V. Financial Regulation

US 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 US 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 the concessions they gained. 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; Boushey 2019, 181–6).

The financial sector enjoyed a combination of financial resources, organizational power, and network ties to the government that enabled it to shape regulatory reforms. 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 US financial regulatory regime not only required a high level of coordination among agencies, but also 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 US 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.<sup>13</sup>

US financial reforms began earlier and proceeded further than in other industrial countries.<sup>14</sup> The SEC forced the stock exchanges to liberalize commissions in 1975. Congress phased out deposit interest ceilings under the Depository Institutions Deregulatory and Monetary Control Act of 1980. It then 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 (negotiable order of withdrawal) 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 of the risks they were taking, the government set the stage for a crisis in the sector by the late 1980s. In 1994, the Clinton administration permitted interstate banking, fueling

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<sup>12</sup> See Vogel 2006, 207–13, and 2019a, 133–9, for further discussion of the literature on the impact of independent directors, stock options, buybacks, and mass layoffs on corporate performance.

<sup>13</sup> US-style private sector innovation in derivative instruments would have been impossible in Japan, for example, 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).

<sup>14</sup> This section builds on Vogel (1996, 223–28) and Vogel (2006, 66–68).

consolidation. The large commercial banks and investment banks aggressively lobbied Congress to repeal the Glass-Steagall Act, prevailing in 1999 with the Financial Services Modernization (Gramm-Leach-Bliley) Act, which allowed banks, securities firms, and insurance companies to forge financial conglomerates.

US financial institutions subsequently 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 bigger risks and earn higher profits. Most major US investment banks transitioned from partnerships to publicly listed corporations in the 1980s and 1990s. 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 use them for speculation. The government relied heavily on self-regulation for high-net-worth traders and institutional investors as well as 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 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 eroded family income by 7.7% from 2007 to 2010, from \$49,600 to \$45,800. Unemployment surged from 5% in January 2008 to 10.2% 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% in 2007 to 15.1% in 2010 (Kelleher, Hall, and Bradley 2012, 13-58). The crisis moderated inequality in the short run by destroying so much wealth, but the resolution of the crisis favored finance executives rather than homeowners and enabled a return to the pre-crisis pattern of inequality. Congress strengthened financial regulation with the Dodd-Frank 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).<sup>15</sup> 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 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. Philippon and Reshef (2012) find that finance sector workers earned comparable wages to workers in other sectors until 1990, but gained a 50% premium by 2006. Meanwhile, top finance executives gained

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<sup>15</sup> Philippon calculates the “unit cost of financial intermediation” as the ratio of the income of financial intermediaries to the quantity of intermediated assets.

a 250% premium by 2006. Piketty (2014, 380) estimates that 20% of those with income in the top 0.1% in the United States in the 2000-10 period were financial professionals.

## VI. Labor Relations

Corporate governance and financial reforms propelled soaring income at the high end of the US labor market, but labor law and regulation help to explain the income stagnation for most other Americans.<sup>16</sup> 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 by changes in the law itself, at least at the federal level. Industry fought off legislation to preserve union strength, pressed national leaders to undermine it, and lobbied state governments to pass laws hostile to labor. Meanwhile, employers actively combatted union organization and grew more willing to lay off workers (Wilensky 2012, 157–58). The unions' loss of leverage vis-à-vis employers was compounded by declining political power, and that contributed to the 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. Union bargaining coverage (the percentage of workers covered by collective agreements) has dropped in the United States, but it has remained stable in some countries and increased in others (see Table 3).

**Table 3. Union Bargaining Coverage in Various Countries, 1970 versus 2017**

Country	1970	2017
Austria	95	98
Belgium	85	96
Canada	34	30
Denmark	80	84
Finland	73	89
France	70	98
Germany	85	56
Italy	80	80

<sup>16</sup> Stansbury and Summers (2020) argue that declining worker power has redistributed rents from labor to capital by boosting the profitability and market valuations of businesses, slowing wage growth, and lowering the labor share of income. They contend that the declining power of labor provides a more compelling explanation for these trends than the increasing market power of firms. They find that labor rents have declined from 12% of net value added in the nonfinancial corporate business sector in the early 1980s to 6% in the 2010s. They suggest that this has increased inequality in labor incomes as well as the distribution between capital and labor.



Japan	35	17
Korea	14	12
Netherlands	73	79
Norway	65	67
Sweden	78	90
Switzerland	50	49
United Kingdom	73	26
United States	30	12

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 a 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.<sup>17</sup> 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 fees. Unions and their allies failed in several key efforts to pass labor reform due to industry resistance and 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 fees 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 US job loss rate reached 10% in the 1980s, and then 14% in the 1990s. Gregory Jackson (2005, 424) calculates that US firms were 4.6 times more likely than Japanese firms to have workforce reductions greater than 10% in 1991. The decline of union power, combined with the rise of the shareholder model, contributed to a long-term

<sup>17</sup> They estimate that union decline explains one-third of the increase in wage inequality for men and one-fifth for women from 1973 to 2007 (Western and Rosenfeld 2011, 514).

decline in labor compensation as a share of national income, from 62.6% in 1990 to 57.1% in 2018 (US Bureau of Labor Statistics 2018).

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 curtailed competition among employers in labor markets with non-compete clauses in employment contracts and used mandatory arbitration to limit damages in employment disputes. Firms in the gig economy such as Uber took advantage of the classification of their workers as contractors to avoid collective bargaining and paying benefits (Collier, Dubal, and Carter 2018).

## VII. 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 US 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 superstar firms, which garnered much higher returns than other companies, and their superstar managers. 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 (Boushey 2019, 114–41). Philippon argues that the decrease in competition in the US 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 decreased dramatically. Dau-Schmidt et al. (2000) report 161 Department of Justice antitrust cases from 1975–79, 127 cases from 1980–84, and 83 cases from 1985–89.

William Baxter, a head of the Department of Justice's Antitrust Division under Reagan, 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). 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 quantity, quality, 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 antitrust authorities were 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 of Economic Advisers 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).<sup>18</sup>

The antitrust regime faced particular challenges in information technology given the powerful network effects in that sector. Consumers want goods and services that interoperate with what they already have, or with what others have, and they will pay more for them. So, market leaders such as Microsoft 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 platforms (Kenney and Zysman 2016; Khan 2017). The Federal Trade Commission (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.<sup>19</sup> 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 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 US antitrust policy and enforcement. Congressional leaders held highly publicized hearings, and the FTC and the Department

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<sup>18</sup> 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.

<sup>19</sup> Google had 92% search engine market share worldwide as of August 2019 (Statcounter 2019).

of Justice Antitrust Division showed signs of taking a tougher line, culminating in their filing of major new antitrust suits against Google and Facebook in parallel with actions by dozens of state attorneys general in late 2020.

### VIII. Regulatory Reform

While US antitrust policy shifted toward a more *laissez-faire* stance, regulatory reform moved in a more pro-competitive direction. The US 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 monopolistic 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 reregulation 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.<sup>20</sup> In principle, pro-competitive regulation should shift firms from rent extraction to value creation, and this should reduce corporate rents and raise consumer welfare. In practice, however, regulatory reform often liberated firms to adopt strategies to favor profits over wages, investment, and other public-interest goals such as universal access to service. The politics, business strategies, and public welfare consequences varied considerably by sector.

Regulatory reform benefited public welfare the most 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 Telecommunications Act of 1996 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 (Chao and Park 2020).

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<sup>20</sup> Hsu (2015) argues that US 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.

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 the resulting flawed market designs 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 US regional electricity markets have developed more successful market designs.

The airline sector provides an intermediate case between the broad public benefits of telecommunications and the private rent extraction of California electricity. The Civil Aeronautics Board began to approve substantial discounts on airfares 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. US 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 by 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. Philippon (2019, 35–9) confirms that market concentration in the sector dropped from the 1970s through the mid-1980s and then increased after that. Air travel prices rebounded after 2009, and the sector has been dominated by four carriers since 2014.<sup>21</sup>

## IX. Intellectual Property Rights

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 (IP), so the specific terms affect everything from profits to prices, wages, investment, and economic growth (Schwartz 2016, 237). The US IP regime has contributed to growing inequality by enabling firms that enjoy the benefits of IP protection to increase their profits and salaries for managers and core workers at the expense of other firms, workers, and consumers. High-profit firms with IP share their rents with a relatively small core of workers, while many firms in more competitive industries squeeze their workers with lower wages and less favorable work conditions. The US firms with the highest level of profits are concentrated in those sectors characterized by a high reliance on IP, especially pharmaceuticals and high technology. These firms tend to reduce their labor footprint by outsourcing and offshoring. They have less incentive to invest because IP gives them a monopoly for a given product or process, and they can leverage their portfolio of IP to fend

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<sup>21</sup> US market share for 2019 according to IBISWorld (2019) shows Delta at 22.7%, American at 21.1%, United at 18.5%, and Southwest at 15.2%.

off competition. And they are better positioned to shift profits to low-tax venues because they rely heavily on intangible assets (Schwartz 2016). Sectors that rely heavily on IP tend to exhibit high returns to scale, with high fixed costs and low marginal costs, and that can translate into a winner-take-all dynamic with high profits for the dominant firms and outsized incomes for superstar individuals (such as athletes or entertainers). The IP regime “accelerates the inequality snowball because those with wealth and power have the greatest access to protection (Kapczynski 2017). The IP regime in the pharmaceutical sector has also contributed to inequality by encouraging innovations valued by the wealthy over those needed by the poor and fueling high drug prices for consumers (Boushey 2019, 120–1).

The US patent regime has transformed since 1980 as the government has extended 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 and generated opportunities for rent-seeking, including the patent “thicket” and “troll” phenomena discussed in the next paragraph. 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 US 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, commonly known as the Federal Circuit, for patent cases, and in 1998 this court 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 demanded financial settlements or sought judgments through litigation.<sup>22</sup> 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 also transformed copyright policy, prompting battles between content producers that sought maximum copyright protection and content users and Internet firms that wanted the freedom to copy and share content. The cost of producing copied works had served as a major impediment to copyright infringement in the past, but digital technology made it essentially costless to reproduce works by copying computer files. This undermined sources of profit for IP owners, so they fought back in the political arena. For example, they pushed for the 1998 Digital Millennium Copyright Act (DMCA), which 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

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<sup>22</sup> Non-practicing entities’ share of all patent lawsuits in the United States increased from 20% in 2006 to 67% in 2013 (Scott Morton and Shapiro 2014, 466).

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). Overall, the costs of the copyright regime have increased while the benefits have diminished in the digital age because IP protection impedes the diffusion of knowledge and the collaborative models of production enabled by the new technology (Benkler 2017).

## **X. The Prospects for Reform**

These case studies demonstrate how political and market strategies have combined to propel the inequality snowball in the United States since 1980. 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 reforms could shift the balance away from those with the most wealth and power, thereby not only moderating inequality in the short run but also curtailing the accumulation of inequality over time.

For example, the US 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 reorient the financial system from enriching financial institutions and finance executives toward serving the broader public of financial consumers by enforcing the fiduciary rule (which requires financial advisors to serve their clients' best interests), imposing a financial transaction tax, and strengthening consumer protection. It could transfer power from employers to workers by lowering the hurdles for union formation, permitting multi-level bargaining, reclassifying contract workers, and prohibiting non-compete clauses and mandatory employment arbitration agreements. 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 advantage from intellectual property owners to challengers, consumers, and patients by narrowing the scope and reducing the duration of IP protection (Vogel 2019b).

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 its social costs. 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 deserve and consumers greater value for their dollar.

But if wealth and power reinforce each other over time, then does the marketcraft reform agenda really have any chance? The argument presented here suggests potential reasons for pessimism, and for optimism. On the one hand, it recognizes that the propensity for those with wealth and power to seek further advantage is a universal feature of capitalism. On the other hand, it stresses that this dynamic varies considerably over time and space. And if the balance of power can shift incrementally in the direction of those with wealth and power at some times in some places, it can move the other way as well. Moreover, there are moments such as the New Deal or post-World War II recovery or the civil rights movement when the US government has made more substantial moves toward greater equity and inclusion. And the current combined public health, economic, and ecological crises might also present the conditions for such a transformation.

The inequality snowball model, and its extreme variant in the United States of the past 40 years, also suggests that political institutions are critical to the capacity to reform. That means that political reforms such as limiting corporate campaign contributions or expanding voting rights may be pre-requisites to enacting a marketcraft reform agenda. Likewise, it suggests that those elements of the agenda that constrain *both* the political *and* the market power of dominant firms—such as antitrust and labor regulation—should be prioritized because they could doubly constrain the inequality snowball.

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