The Marketcraft Solution:

How the Government Can Reshape Markets to Make Them Work Better – For Everyone

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ABSTRACT

The postwar international order reflected a compromise of "embedded liberalism." That is, the United States, Western Europe, and Japan embraced a liberal international economic regime but they balanced this with domestic policies to reduce their vulnerability to market fluctuations. These social compacts have since unraveled, as policies since the 1980s that purportedly aimed to liberate markets from government interference actually skewed market rules in favor of powerful interest groups.

In this essay, I argue that a New Deal for this century should focus first and foremost on the lost art of "marketcraft" that was embodied in the original New Deal. By this I simply mean the design of the legal and regulatory infrastructure that makes modern markets work, including everything from corporate governance to financial regulation, labor practices, antitrust policy and intellectual property rights. I refer to this as marketcraft because it constitutes a core function of government roughly comparable to statecraft. This does not mean that the government always gets it right. Just as statecraft can be brilliant or blundering – so it is with marketcraft.

The marketcraft reform agenda strives to rebalance the market rules from shareholders to stakeholders, from bankers to borrowers, from employers to workers, from incumbents to challengers, and from intellectual property rights owners to consumers. It aims not to rig the economic system in favor of the poor and the weak, but to "un-rig" it from favoring the wealthy and the powerful.

The marketcraft agenda is even more fundamental than tax or healthcare reform because it seeks to make markets work better in the first place rather than to redistribute wealth or to correct market defects after the fact. It is particularly conducive to win-win outcomes because it seeks to eliminate distortions that undermine both growth and equity. While the marketcraft agenda can be rather arcane in its finer-grained detail, it is rather simple at its core. It seeks to give workers fair wages and consumers fair value. It seeks not to contain American capitalism but to revitalize it.

The New Deal fundamentally reshaped the rules that enable markets to flourish, workers to earn good wages, and consumers to pay fair prices. And this set the stage for the inclusive prosperity of the postwar era in the United States. Meanwhile, other industrial countries like Germany and Japan forged their own versions of "embedded liberalism."[1] That is, they developed domestic economic regimes that combined market regulation, public investment, and social welfare to safeguard domestic stability while integrating into the emerging liberal international order. Yet the social compacts of the postwar era have since unraveled, and the U.S. government now confronts the challenge of forging another New Deal for this century.

In this essay, I argue that the new New Deal should focus first and foremost on the lost are of "marketcraft": the legal and regulatory infrastructure that makes modern markets work, including everything from corporate governance to financial regulation, labor practices, antitrust and intellectual property rights.[2] More effective marketcraft can make markets work for everyone: shareholders and stakeholders, lenders and borrowers, employers and workers, incumbents and challengers, and intellectual property owners and consumers. This is not only a prerequisite for inclusive growth, but also for a healthy democracy.

Market Rules as "Marketcraft"

In an influential treatise, the RAND Corporation economist Charles Wolf Jr. once described the cardinal economic choice as one of *Markets or Governments: Choosing between Imperfect Alternatives*. He was right about the "imperfect" part – but wrong about the "alternatives." We often frame economic debates in exactly this way, as if governments and

[1] John Gerard Ruggie, "International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order," *International Organization* 36/2: 1982, 379-415.
[2] This essay builds on Steven K. Vogel, *Marketcraft: How Governments Make Markets Work* (New York: Oxford University Press, 2018).

markets were alternatives. But they are not, for a deceptively simple reason: it is governments that make modern market systems work. So limiting the government role is just as likely to undermine markets as to liberate them. In fact, one cannot empower modern markets without government.

This basic recognition has some rather profound implications for how we think about policy issues today. It means that government regulation does not constitute "intervention" in an otherwise free market. In some cases, the language of intervention might be appropriate. For example, if a central bank buys or sells assets to manipulate the exchange rate, that might be viewed reasonably as intervention into what is more commonly a private sector activity. But if the government refines disclosure rules so that investors can make better decisions when trading stocks, it is not constraining financial markets but enabling them. And if it prohibits "non-compete" clauses in employment contracts, it is not inhibiting labor markets but invigorating them.

If governments necessarily govern markets, then it follows logically that they should strive to do so effectively. In many cases, there is simply no alternative to government regulation. The choice is not whether the government should regulate, but how. For example, the corporation – the institution at the very heart of modern capitalism – is a legal construct. So the government cannot opt out of its responsibility to establish and enforce corporate law. It can adopt a civil law or a common law system, or it can favor federal or state charters, but it cannot say "Well, let's just leave that to the free market."

In other cases, the functional alternative to government regulation is private sector governance. In these instances, the question is not whether to regulate but rather who should regulate. Should the government regulate or should the market players govern themselves? While government regulation may be imperfect, self-regulation can be worse. The alternative to government regulation is not the perfect market of economic theory but rather the very imperfect world of markets thoroughly sullied by collusion, fraud, and imbalances of power. 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.”[3] In fact, it is often government regulation that presses firms to compete rather than to collude, or to improve productivity rather than just to extract “rents” (excess returns) from workers, consumers, and other firms.

In yet other cases, the alternative to regulation is no market at all. In order to create a market to allocate electromagnetic spectrum among mobile telephone and broadcast companies, or a market to trade rights for carbon emissions, the government has to fabricate the market from scratch.

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To contemplate the stakes involved, just consider the greatest economic success story and the greatest failure of the past several decades – the digital revolution and the global financial crisis. The former generated the greatest surge in human capacity and productivity of our time, and the latter produced the worst global economic crisis since the Great Depression. Yet they are both products of good old home-grown American marketcraft. The contrast between the two cases is quite revealing. They not only show that the United States is capable of both success and failure in marketcraft, but they offer important hints about what accounts for the difference. The U.S. government did not have a master strategy for the digital revolution, but it did exhibit three key features lacking in the finance case: administrative capacity, a long-term perspective, and relative

[3] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Chicago: University of Chicago Press, 1976), Vol. 1, 144.

insulation from interest group pressures. The government "created" the Internet in the sense that the Defense Department's Advanced Research Projects Agency (DARPA) funded the development of the ARPANET, which provided the underlying architecture. The U.S. government funded the research that produced much of the relevant technology, and provided early-stage capital for many of the most successful high-tech firms.[4] And U.S. antitrust policy supported the digital revolution by preventing vertically integrated firms like IBM and AT&T from dominating the electronics sector. In finance, in contrast, the authorities were captured by the financial institutions they were supposed to be regulating. The regulatory agencies were fragmented, and wary of imposing regulations that irritate important market players or might spook the markets. So we should not be too surprised that the outcome was different.

Focusing on marketcraft fundamentally transforms the policy agenda. It opens up a whole new arsenal of tools to address the policy challenges of today. If there are multiple ways to design a market, and one is not clearly more efficient than another, then the government can reasonably consider goals other than efficiency in choosing among them. It might structure markets to promote technological innovation, to conserve resources, or to empower workers. And it should.

The Postwar Liberal Order

International relations scholar John Ruggie describes the postwar international order as one of "embedded liberalism." The international economic regime was "liberal" because it promoted trade and investment among the industrial nations based on a multilateral framework. But it was "embedded" because it left substantial leeway for national governments to pursue policies of economic management, market regulation, and social services to moderate domestic adjustment

[4] Mariana Mazzucato, *The Entrepreneurial State: Debunking Public vs. Private Sector Myths* (London: Anthem Press, 2014), 73-112.

costs. The regime thus represented a delicate compromise between international integration and domestic stability that was critical to its durability.[5] Ruggie references the renowned political economist Karl Polanyi with the conception of embeddedness. In his magisterial work, *The Great Transformation*, Polanyi offers a particularly compelling account of how governments created an integrated market system that included markets for labor and land and overthrew the feudal social structure in the nineteenth century. He also introduces the notion of a "double movement" whereby the shift toward a market economy was countered by social movements to protect humans and nature from the worst ravages of market competition.[6] Ruggie notes that the rich democracies of the postwar era developed a variety of different policy mixes and institutional arrangements to buffer themselves from the international economy, but he stresses that they shared a belief that national governments had a legitimate right to pursue domestic strategies to ensure economic growth, public welfare, and social order.[7] This historic compromise has since unraveled, unleashing the populist backlash against the liberal international order that has exploded across the United States and many other industrial nations in recent years.

While we tend to think of the welfare state as the core element of these domestic regimes, market regulation formed an equally critical pillar. In the United States, the postwar model began to take form under the original New Deal in the 1930s. For example, the Banking Act of 1933 separated commercial from investment banking and created the federal deposit insurance system. The Securities Act of 1933 mandated financial information disclosure, and the Securities Exchange Act of 1934 created the Securities and Exchange Commission. The National Labor Relations Act of 1935 guaranteed collective bargaining rights and prohibited employer practices that would

[5] Ruggie, "International Regimes."
[6] Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (Boston: Beacon Press, 1944).
[7] Ruggie, "International Regimes."

undermine them. These reforms enabled financial markets to deliver more value to the economy and gave workers more bargaining power.

In Germany, as in many continental European countries, the government relied on a "democratic corporatist" form of governance whereby peak associations representing industry and labor were represented at all levels of policymaking. This gave both sides veto power on major decisions, fostered a consensual policy process, and enabled the government to manage complex tradeoffs among policies.[8] Large corporations were required by law to adopt "codetermination," whereby labor representatives held up to half of the seats on supervisory boards. And wages were set by collective bargaining at the sectoral level. Firms in many sectors developed collaborative vocational training systems that raised skills and fostered Germany's high-quality production regime in industries ranging from machine tools to automobiles. Meanwhile, the financial sector was tightly linked to industry via the "hausbank" relationship banking system; block shareholding, whereby banks held substantial stakes in many firms; and a powerful network of state government-run banks (the Landesbanken) with a mandate to support local industry.[9]

Japan was also characterized by a corporatist pattern of policy making, but one that featured close collaboration between government and industry and not labor since the dominant Liberal Democratic Party (LDP) did not rely on unions for political support.[10] The LDP strongly protected other vulnerable groups, most notably farmers and small retailers, with trade protection, market regulation, and subsidies. Large manufacturers adhered to a "lifetime" employment system whereby they avoided layoffs if at all possible, and they fostered the strong labor-management

[8] Harold L. Wilensky, *Rich Democracies: Political Economy, Public Policy, and Performance* (Berkeley and Los Angeles: University of California Press, 2012).
[9] Steven K. Vogel, *Japan Remodeled: How Government and Industry Are Reforming Japanese Capitalism* (Ithaca, NY: Cornell University Press, 2006), 69-77, 151-6.
[10] T. J. Pempel and Keiichi Tsunekawa, "Corporatism Without Labor? The Japanese Anomaly," in Philippe C. Schmitter and Gerhard Lehmbruch, eds., *Trends toward Corporatist Intermediation* (London: Sage, 1979), 231-70.

collaboration that helped them to cultivate their distinctive quality control system. The government mobilized the financial sector to allocate credit to favored sectors, and firms organized into dense networks of alliances (keiretsu) that helped them to ride out economic downturns and insulated them from financial market pressures.[11]

Political scientist Peter Katzenstein fleshes out Ruggie's argument in his classic study of the smaller countries in Western Europe. He argues that it was no accident that the countries that were most exposed to international competition – such as Sweden, Norway, Denmark, the Netherlands, Belgium, Austria and Switzerland – had some of the most vigorous industrial adjustment policies. These countries were highly dependent on world markets, so protectionism was not an option. Hence they devised economic and social policies to prevent international market fluctuations from causing political disruption.[12] These same countries also featured high tax and high spending regimes that allowed them to combine strong economic growth with a remarkable record on many dimensions of social performance, such as education, health, and economic equality.[13]

In the United States, meanwhile, the government focused less on marketcraft after the New Deal. The American policy innovations of the postwar era centered more on Keynesian macroeconomic policies, welfare services, social regulation, and equal rights. Then in the 1970s, the United States and other industrial countries confronted the end of the postwar golden age with the onset of stagflation in the wake of the oil shocks. The public lost confidence in the efficacy of the mixed economy, and this provided the political opening for Margaret Thatcher, Ronald Reagan

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[11] Vogel, *Marketcraft*, 78-89.
[12] Peter J. Katzenstein, *Small States in World Markets: Industrial Policy in Europe* (Ithaca, NY: Cornell University Press, 1985).
[13] Wilensky, *Rich Democracies*, and Harold L. Wilensky, *American Political Economy in Global Perspective* (New York: Cambridge University Press, 2012).

and others to adopt "neoliberal" reform programs of cutting taxes, loosening financial regulation, attacking union power, and easing antitrust enforcement. They adopted the language of "free markets," building on economic thinkers such as Friedrich Hayek and Milton Friedman. The continental European countries and Japan subsequently followed with their own variants of neoliberal reforms, albeit to a lesser degree.

Yet Reagan's policies were not really about "deregulation" in the literal sense of reducing regulation, but rather about a reorientation of market rules to benefit the wealthy and powerful.[14] The free market rhetoric disguised a program that was more about shifting rules than eliminating them. In the process, the governance model shifted away from the New Deal regime that had buttressed inclusive growth. The neoliberal ideology that viewed government as an obstacle to the free market rather than as the architect of markets became so pervasive that progressives internalized some of its core precepts even as they battled the resulting policies. They proposed remedies for specific "market failures," for example, rather than a more fundamental transformation of markets. And the Democratic administration of Bill Clinton adopted some elements of the neoliberal program, including trade liberalization and financial deregulation.

The Reform Opportunity

The financial crisis of 2008 exposed some of the flaws of this neoliberal policy shift. It demonstrated how financial deregulation – including the non-regulation of financial derivatives – sowed the seeds of a crisis of devastating proportions.[15] Yet the crisis did not immediately beget a paradigm shift in economic policy. The Barack Obama administration successfully contained

[14] Steven K. Vogel, *Freer Markets, More Rules: Regulatory Reform in the Advanced Industrial Countries* (Ithaca, NY: Cornell University Press, 1996).
[15] Dennis Kelleher, Stephen Hall, and Katelynn Bradley, "The Cost of the Wall-Street Caused Financial Collapse and Ongoing Economic Crisis is More Than $12.8 Trillion" (Washington D.C.: Better Markets, 2012).

the crisis with a combination of fiscal stimulus and a bailout of the financial sector, and it enacted the Dodd-Frank bill to reform financial regulation. Yet it offered more support for the financial institutions than for the average citizens who lost their homes. This undermined the Democratic Party's claim as the defender of the middle class, and helped to set the stage for the 2016 election of Donald Trump, who adopted an unorthodox campaign strategy of attacking the elites of both parties. Yet there is a very real possibility that the populist backlash and the collective trauma of the Trump era could open a window of opportunity for more fundamental market reforms in 2020 and beyond. At the least, the Democrats' takeover of the House in 2018 and the run-up to the 2020 presidential election are generating an unprecedented flurry of new proposals, including some that fit squarely within the marketcraft frame advocated here. Senator Elizabeth Warren in particular advocates a fundamental overhaul of market rules to make American capitalism more inclusive.

Following the logic outlined above, it would be entirely appropriate to redesign market governance to promote social goals, including greater equality of opportunity and more equitable distribution of wealth. Some commentators might object that market regulation should not be used to address inequality. But that objection reflects the government-versus-market fallacy noted above. The government would not be intervening in some pristine natural market, but rather in one already sullied with collusion, fraud, and imbalances of power. The government has no choice but to regulate markets so that they function properly, and that inevitably has distributional effects. The government cannot abdicate this responsibility, so it should strive to govern markets as effectively and equitably as possible.

Others might object that any attempt to reset market rules has the potential to favor some groups over others. And they would be right. But there is no such thing as a free market, so there is nothing sacred about the status quo. That does not mean that the government should arbitrarily rig regulation in the favor of particular groups, but it does mean that it should strive to unrig regulations so that they serve the broader public. Market transactions are embedded in relationships of power. Marketcraft determines the balance of power between shareholders and stakeholders, banks and borrowers, employers and workers, incumbents and challengers, and intellectual property rights owners and users. These relationships can be reset – and they should be.

The Marketcraft Policy Agenda

So what would a marketcraft reform agenda look like? Let's briefly review some specific proposals in five policy realms. This short essay cannot delve into the finer details, but it will offer a few examples with some observations on how these measures would promote inclusive growth. Most of these measures have been advocated by others, including scholars, think tanks, and presidential candidates. Nonetheless, the marketcraft concept provides a unifying framework that clarifies the benefits of this cluster of policies in terms of both policy goals and political viability.

Corporate governance

- Create a federal charter for large corporations
- Require chartered corporations to serve public interest goals
- Mandate at least one labor representative and one public interest representative on the boards of large corporations

The U.S. shareholder-centered model of corporate governance has boosted profits and executive compensation, but it has suppressed the wages of ordinary workers and constrained investment. The U.S. CEO-to-worker pay ratio stood at 265 to 1 in 2017, compared to 136 for Germany and 58 for Japan. The Business Roundtable has called for a shift away from the shareholder model of corporate governance to a broader stakeholder model. The reforms listed above would push corporations in that direction, encouraging them to pursue a high-road strategy of enhancing productivity through partnership with their workers.

Financial regulation

• Enforce the fiduciary rule that requires financial advisers to serve their customers' best interests

• Impose a financial transactions tax

• Reinstate regulatory firewalls between commercial and investment banks

• Strengthen consumer financial protection

The financial sector has seized a growing share of the economy without delivering greater benefits to consumers. Economist 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.[16] Moreover, financial sector malpractice fueled the financial crisis that devastated the United States and the world economy. Financial reforms would press the financial sector to provide greater value for investors and consumers at a lower cost and moderate the economy's vulnerability to financial crises.

[16] Thomas Philippon, "Finance versus Wal-Mart: Why Are Financial Services so Expensive?," in Alan S. Blinder, Andrew W. Lo, and Robert M. Solow, eds., *Rethinking the Financial Crisis* (New York: Russell Sage 2012), 235-46.

Labor regulation

• Prohibit no-compete clauses

• Restrict mandatory arbitration

• Permit multi-employer bargaining

• Revise labor law to facilitate union formation

• Reclassify some gig economy workers as employees

The decline of labor power and the labor share of income in the United States 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 has failed to pass measures to preserve union strength; national leaders have undermined it; state governments have passed laws hostile to labor; and employers have deployed practices to discourage union organization.[17] The decline of union bargaining coverage in the United States contrasts with other industrial countries, such as Canada and many Western European nations. Real median wage increases decoupled from productivity growth in the United States around 1980, with the largest share of gains going to the top 1% of earners and not to the middle class. The decline of union power combined with the rise of the shareholder model has 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. Comprehensive labor reform could reset the balance so that American workers earn a fairer share of economic growth.

Antitrust policy

• Allocate more resources to antitrust enforcement

[17] Wilensky, *American Political Economy*, 157-58.

- Strengthen standards for merger approval
- Systematically review the market power of the big tech firms
- Prohibit digital platform operators from competing on their own platform

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 are likely to be challenged by competitors over time. So they advocated a more permissive stance on antitrust enforcement. Mergers surged, including both strategic acquisitions to strengthen core competencies and hostile takeovers designed to boost shareholder returns. 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. And market concentration has enabled labor market monopsony, whereby firms do not have to compete so much to attract workers so they can pay lower wages. The digital platform economy is particularly conducive to monopoly, with platform operators – such as Amazon, Google, and Facebook – establishing dominant positions and setting the terms of competition on their platforms.[18] More rigorous antitrust enforcement could promote innovation, protect entrepreneurs, and boost wages.

<u>Intellectual property rights</u>

- Eliminate patents for software and business methods
- Raise the standards for patent protection

[18] Martin Kenney and John Zysman, "The Rise of the Platform Economy," *Issues in Science and Technology* (Spring 2016), 61-69; Lina M. Khan, "Amazon's Antitrust Paradox," *Yale Law Journal* 126 (2017), 710-805.

- Give the government a share of patent proceeds for innovations that rely heavily on government R&D
- Shorten copyright duration
- Expand allowances for the fair use of copyrighted materials

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.[19] Strong protection in the pharmaceutical sector, for example, has major distributional effects, boosting returns for producers and raising prices for patients. With the digital economy, some of the benefits of strong intellectual property rights (IPR) protection have diminished and the costs have increased, such that a fundamental recalibration of the regime may be required. As patents were extended to software, they began to produce a "patent thicket": a dense web of patent rights that companies must hack through to commercialize new technology.[20] And patent "trolls" – companies that do not have their own inventions but make a business in patents – started to buy up huge numbers of patents (largely for software), search for possible infringements, and demand financial settlements or seek judgments through litigation.[21] In the process, they impeded the development of new products, increased costs for businesses and consumers, and clogged the judicial system. Moreover, strong IPR protection can impede the growth of the collaborative production models that have been enabled by digital technology. Thus

[19] Herman Mark Schwartz, "Wealth and Secular Stagnaton: The Role of Industrial Organization and Inellectual Property Rights," *RSF: The Russell Sage Foundation Journal of the Social Sciences* (2016) 226-49.
[20] Carl Shapiro, "Navigating the Patent Thicket: Cross Licenses, Patent Pools, and Standard Setting," *Innovation Policy and the Economy* 1 (2000), 119-50.
[21] Fiona M. Scott Morton and Carl Shapiro, "Strategic Patent Acquisitions," *Antitrust Law Journal* 2 (2014), 463-99.

thoughtful IPR reforms could spur innovation, boost economic growth, and moderate economic inequality at the same time.

The Marketcraft Advantage

Let me be clear: I am not suggesting that the marketcraft agenda obviates the need for other major changes, such as tax and healthcare reform. But the marketcraft agenda is even more fundamental in that it seeks to make markets work better in the first place, rather than trying to redistribute wealth or to correct for market defects after the fact. It is also particularly conducive to win-win outcomes because it seeks to "un-rig" the economy, thereby eliminating distortions that undermine both growth and equity. And it is market-conforming in that it seeks not to contain markets but to make them work better. While the marketcraft agenda can be rather arcane in its finer-grained detail, it is rather simple at its core. It seeks to give workers fair wages and consumers fair value. It seeks not to contain American capitalism but to revitalize it.

These features of the marketcraft agenda also make it particularly viable politically. If all markets are governed, then everyone should all want them to be governed better. Both social democrats and libertarians should embrace an agenda designed not to rig the economic system to favor the poor and the weak, but to unrig the system from favoring the wealthy and the powerful. Business and labor should both support an agenda designed to shift the United States from the low road of cutting labor costs to the high road of labor-management collaboration. And entrepreneurs and consumers alike should welcome a shift from protecting incumbents to empowering challengers, from tolerating collusion to promoting competition.

The marketcraft agenda also has the potential to revive "embedded liberalism" by making sure that the costs and benefits from international trade and investment are shared more broadly at home. It will help American firms to compete more effectively and American workers to share in the gains from trade. It will moderate political pressure for high tariffs that would undermine growth and hurt both workers and consumers. And it would moderate the popular outrage at our political and economic system that threatens to derail American democracy.

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