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# RIGGED

HOW GLOBALIZATION AND THE RULES OF THE MODERN ECONOMY WERE  
STRUCTURED TO MAKE THE RICH RICHER

# **Rigged:**

## **How Globalization and the Rules of the Modern Economy Were Structured to Make the Rich Richer**

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# Chapter 8

## The Political Economy of an Anti-Rent-Seeking Equality Agenda

Progressives have long been suspicious of the market. Some see it as an aberration to be contained, if not actually overcome. In the extreme case, the goal is some form of central planning in which the government makes the bulk of decisions on allocating resources. More tempered versions have the government taking possession of key industries, with smaller firms and less-consequential sectors left in private hands. The social democratic vision dominant in Western Europe leaves the market largely in private hands. The government provides a safety net to ensure health care, education, and other basic needs, and it acts to redistribute economic gains to partly reverse inequality created by the market, at least.

However, neither vision takes into account the notion that the government structures the market in fundamental ways that determine market outcomes. Both visions largely accept the view of the market held by Friedman-esque conservatives — that it is a fact of nature. Undesirable outcomes such as poverty or extreme inequality are givens, and the issue is the extent to which we want the government to supplant the market or ameliorate its effects.

Markets are not fixed by nature; rather, they are infinitely malleable. They are and can be structured in different ways depending on the desired outcomes. The enormous upward redistribution in the United States of the last four decades was not an inevitable outcome of technology or globalization. It was the result of deliberate policies, the purpose of which was to redistribute income upward.

To sustain progressive politics in the decades ahead it is essential that progressives understand the causes of upward redistribution and get a clearer understanding of the market. The suspicion of market outcomes is a prejudice that needs to be overcome. The market is a tool, like the wheel. Many horrible acts have been done with wheels — young children have been run over by cars, sometimes even deliberately — but no one in their right mind would see this as a serious basis for not using wheels.

In the same vein, we can point to plenty of cases where the market has led to really bad outcomes. Tens of millions of people have faced unemployment. Hundreds of millions have faced poverty and hunger. But these outcomes were not necessary features of a market economy. To some extent poverty has been a result of a genuine lack of resources: actual scarcity. More frequently, poverty is the result of the way we have organized markets and structured property rules. If we had rules designed to lead to more equal outcomes, there would not be so much poverty co-existing alongside great wealth for the few.

The chapters in this book have outlined ways in which different policies can be put in place to reverse the upward redistribution of income. This chapter discusses some of the political economy issues around these policies and assesses the political coalitions that could potentially advance the economic agenda described in this book.

### **The full employment agenda**

In principle, a full-employment agenda should be the easiest goal among the major policy areas, since the winners hugely outnumber the losers. Full-employment policy, first and foremost, is explicitly about making the pie larger, even if full employment also has important implications for distribution. We are foregoing a great deal of potential

output simply because there is not enough demand in the economy. With more demand, the economy will produce more, more workers will have jobs, and in principle everyone can be better off.

The potential gains from maintaining a full-employment economy are enormous compared to almost any other policy. In 2008, before the severity of the recession was clear, the CBO projected that GDP in 2015 would be \$20.5 trillion in 2016 dollars, \$2.3 trillion more than it actually was in 2015. The cumulative gap between the CBO's 2008 projection and actual GDP from 2008 to 2015 is more than \$13.5 trillion, which comes to \$42,000 for every person in the United States. Even if we assume that the CBO hugely overstated the economy's potential back in 2008, the lost income would still be enormous.

We don't have to speculate about the benefits from a full-employment policy since we experienced it in the late 1990s. In 2000, when the unemployment rate fell to 4.0 percent as a year-round average, the economy was 11.7 percent larger than the CBO had projected it would be back in 1996. This difference is the equivalent of \$2.2 trillion in the economy of 2016, or \$6,800 per person.

The gains from getting to full employment will not be evenly shared. They will go disproportionately to blacks and Hispanics and to people with less education. This was the case in the boom of the late 1990s, though it's not clear that there need be losers at all. The profit share of income may drop somewhat, but if the pie is larger, businesses can still come out ahead. After all, few corporations saw 2000 as a disastrous year.

The impact of full employment will vary across sectors. Businesses that depend on low-wage labor will face difficulties as workers with better options either leave or demand higher pay to stay. A predictable result of a full-employment economy is that we will have fewer convenience stores and fast food restaurants, since some of these businesses will not be profitable if workers are paid a substantially higher wage.

Other businesses may take a hit as wages for many of their employees rise rapidly due to a tight labor market. For example, the clerical staff at a legal firm or the custodians in a software company can be expected to receive higher pay in a tight labor market, and their gains may

have some modest effect in reducing profits if the costs cannot be fully passed along.

However, some businesses will benefit from an increase in demand. Traditionally, a major beneficiary of a high-employment economy has been the manufacturing sector. Auto and steel manufacturers can expect to see higher profits as increased demand pushes them closer to capacity. Their ascent may be somewhat less lofty today than it was 30 to 40 years ago as these companies are increasingly competing in a global market, but most manufacturing firms are still likely to see an increase in demand as a net positive for their bottom lines.

If there is an industry that is a plausible loser from a strong economy it would be the financial sector. Banks and other financial firms will almost always have a large volume of long-term loans on their books. While securitization has reduced the volume of loans that these firms are likely to hold on their books, they are almost certain to still be on net holders of long-term debt. They stand to lose if increased wages lead to price increases and higher inflation. Since their loans are almost always set at a fixed rate, e.g., a five-year car loan at 4.0 percent interest, the value of the repayment will decline if inflation rises.

To take the simplest case, if they offered the 4.0 percent car loan with an expectation that inflation would be 1.5 percent, the bank would have expected a real interest rate of 2.5 percent (4.0 percent minus 1.5 percent). If the inflation rate ends up being 2.5 percent then the real interest rate on this loan falls to 1.5 percent (4.0 percent minus 2.5 percent). The bank will then have taken a large loss on this loan since it will be getting substantially less money in real terms than it had anticipated due to the rise in the inflation rate.

Fear of inflation is why many financial firms are opposed to full-employment policies. They may see little gain from the prospect of more growth and lower unemployment (bankers and their families are not the ones typically hurting in a recession), while they face a big risk to their profits if full employment leads to higher inflation. But different businesses within the financial sector may have different interests. Increased growth will increase the opportunity for making loans, a clear source of profit. And a stronger economy will improve the average quality of loans,

reducing the number of defaults. Since banks can take large hits on defaulted loans, a lower default rate is a big plus for the financial sector. Nonetheless, the financial sector does seem to be the place where there are the greatest concerns over inflation, and for this reason, the greatest source of pressure against full-employment policies that could lead to more inflation.

But obstacles to full-employment policies exist well beyond those sectors with a direct interest in preventing inflation and keeping workers from gaining more bargaining power. Tens of millions of ordinary workers, who would win from expansionary fiscal and monetary policies designed to lower the unemployment rate, staunchly oppose these policies.

The problem is the prevailing myths about the virtues of austerity and fears about easy money. Polls and focus groups regularly find that the story that the government budget is like a family budget has enormous appeal, but few people have a clear enough understanding of the economy to recognize that this analogy is inappropriate. Everyone understands that using credit cards to balance income and spending each month will lead to trouble. The idea that the government's finances are qualitatively different — that the government does not face the same constraints as a family — strikes most people as bizarre and fanciful.

The same attitudes apply to expansionary monetary policy. The notion that the government can print money and thereby create wealth seems crazy. Everyone has heard stories of Weimar Germany, or more recently Zimbabwe, where governments facing economic crises sought to resolve their problems by printing money. It is difficult to distinguish the idea of printing money when demand is weak and printing money when the government can't pay its bills. If these two situations look similar to people, it is understandable that they would prefer to be on the safe side and avoid the risk of hyperinflation. This preference for security probably explains the continuing appeal of the gold standard even for an economy that has been suffering from too little inflation rather than too much.<sup>104</sup>

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104 It is also true that few people have any clear idea of the actual rate of inflation in the economy. Most people are not following economic statistics closely. Their

Politicians are happy to exploit this confusion even in the cases where they do not share it themselves. (Most politicians have not studied economics extensively, so there is little reason to believe that most of them have a clearer understanding of these issues than the bulk of the population.) For example, many Democrats who likely recognize the virtues of deficit spending, will tout the budget surpluses of the Clinton years as a triumph of wise policymaking. They contrast their fiscal prudence with the reckless tax cutting of Republicans.

While the purpose of Republican tax cuts may be to give more money to the wealthy, the idea that the economy will often benefit from larger deficits is accurate. Deficits driven by tax cuts for higher-income people offer less of a benefit for the economy than deficit spending on infrastructure, education, or child care because in the former case some of the money is saved, not spent, while in the latter case all of the money is spent, providing a larger short-run boost to the economy and a long-term boost to productivity from the investments. But the constant warnings about deficits make it difficult to gain political support for progressive stimulus measures.

For example, then-Senator Obama knew better back in 2006 when he said that a vote to raise the debt ceiling “is a sign of leadership failure. It is a sign that the U.S. government can’t pay its own bills.” He voted against raising the debt ceiling (Kessler 2013), even though he presumably knew that there was no problem with the federal government running the modest deficits of 2006 and that there was no problem with raising the debt ceiling, which simply authorizes borrowing to meet commitments already made. He was making a pitch that would resonant politically because most of his constituents did not understand the way the economy works and the difference between their own borrowing constraints and the federal government’s. He chose to reinforce these misconceptions for short-term political gain.

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perception of inflation will be determined by the prices that they happen to see. And, it is also likely that rising prices will have more of an impact on their perceptions than stable or falling prices, so a jump in the price of milk or gas will stand out, even though the prices of most other items might be stable or falling (Federal Reserve Bank of New York 2010).



There is no simple route for circumventing the large-scale confusion people have about the basics of macroeconomic policy. The public's conservatism on these issues is deeply held and believed to be common sense. Few people spend their time contemplating the dynamics of the economy or studying the history of instances of successful fiscal and monetary stimulus. Unless the public deepens its economic understanding, it will be difficult to overcome the fear of debt as a barrier to full employment. This task is not made any easier by the fact that there is a whole industry devoted to fanning these fears.<sup>105</sup>

If it is not possible to make progress on full employment through larger budget deficits, the obvious alternative is smaller trade deficits. In this case, the popular prejudices go in the right direction. Just as people think it is bad for the government to run a deficit, they also generally believe it is bad for the country to be running a trade deficit. And when we are below full employment, they are right.

A simple remedy for a trade deficit is to reduce the value of the dollar, because a lower-valued dollar makes U.S.-made goods and services more competitive internationally. With a lower-valued dollar, our exports become cheaper for other countries; therefore, they will buy more of them. On the other hand, imports become relatively more expensive, meaning that we will buy fewer imported goods and more goods produced here. The result is more domestic demand and more jobs, bringing us closer to full employment.

While this route may seem straightforward, powerful industries have a direct interest in blocking it. As discussed in Chapter 3, many U.S. corporations directly profit from the trade deficit. Most major manufacturing firms produce a substantial portion of their parts and/or products in other countries. They are not anxious to see the cost of the items they import rise by 15–20 percent, if the dollar falls by a comparable amount. Also, major retailers like Walmart have worked hard

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105 The private equity billionaire Peter Peterson has devoted a substantial portion of his wealth to supporting organizations that promote fears of budget deficits. This list includes the Concord Coalition, Fix the Debt, the Committee for a Responsible Federal Budget, and others.

to establish low-cost supply chains in the developing world. They don't want to see the prices they pay rise sharply due to a drop in the dollar.

Another obstacle is the need to negotiate a lower-valued dollar with China and other major trading partners. These negotiations will involve trade-offs, and making a lower-valued dollar a top priority would mean downgrading some industry priorities, like Microsoft's enforcement of its copyrights or Pfizer's enforcement of its patents. It would also mean downgrading demands from Goldman Sachs and other banks for increased access to foreign financial markets or Verizon to telecommunications markets. These are not trivial obstacles.

One argument that should not be accepted is the claim that we should accept higher trade deficits — and by implication lower employment — because smaller trade deficits will hurt poor people in the developing world. But as pointed out in Chapter 1, this contention is just bad economics. Relatively fast-growing developing countries should be borrowing capital from rich countries like the United States, which means that they should be running trade deficits in order to build up their capital stock and infrastructure. As a practical matter, successful developing countries like China, South Korea, and Taiwan have eschewed this practice by running trade surpluses while experiencing growth. However, their experience reflects a serious failing of the international financial system, which has not supported regular flows of capital from rich countries to poor countries. So instead of pointing fingers at workers in the United States and other rich countries who just want to be employed, we should take a hard look at the actions of the IMF and U.S. Treasury Department.

Another route toward full employment is shortening average work time. As was noted in Chapter 3, Germany managed to reduce its unemployment rate in the Great Recession, even though it was experiencing a steeper falloff in output than the United States, because it encouraged firms to reduce hours rather than lay off workers. There is both a short-term cyclical aspect to this issue and a longer term institutional dimension. The short-term is simply the structure of the system of unemployment benefits. The unemployment system in the United States is primarily designed to encourage layoffs, rather than

shorter hours, since workers can more easily be compensated for layoffs. In the longer term, the German experience speaks to trends in work hours. In other wealthy countries, the length of the average work year decreased dramatically over the last four decades. A benefit of shorter work weeks is that more workers have the opportunity to work at better-paying jobs.

There has been some progress in both areas in recent years in large part because these are policies that can be put in place at the state level or in some cases even the local level. In terms of unemployment benefits, 29 states and the District of Columbia now have a work-sharing (short-time compensation) program as part of their system of unemployment insurance. Take-up rates have been low because many employers are unaware of the program and because the system is highly bureaucratic and difficult for employers to use. However, this is an area where progress can, in principle, be made without too much difficulty. It should be possible to better publicize work-sharing programs so that employers at least know they have the option as an alternative to layoffs. And if the existence of work-sharing programs were more widely known, workers may pressure their employers to go the work-sharing route. As for the bureaucratic side, most of the existing programs were designed in the late 1970s or early 1980s. In many cases, they require filing forms on paper. There are also many aspects of these programs that unnecessarily make work sharing far more difficult for employers than just laying off workers. In order for take-up rates to expand significantly, the rules must be adapted so that they don't impose needless burdens.<sup>106</sup>

In terms of hours more generally, the incentive for companies in the United States is to have fewer workers putting in longer hours rather than to have more workers worker fewer. The issue is overhead costs per worker, but those costs are falling as employers reduce their benefits — defined benefit pensions, for example, are rapidly disappearing from the private sector — and as the Affordable Care Act (ACA) reduces the dependence of workers on employer-provided health insurance. While the

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106 The federal government set aside money for the modernization of the program and provided subsidies to states to use work sharing (Baker and Woo 2012).

ACA does not seem to have had much impact on employer-provided insurance thus far, a larger share of the workforce is likely to procure insurance through the exchanges in the future. If pension and health care benefits are no longer a per-worker cost, then employers have less incentive to force workers to put in longer hours rather than just hiring more workers.

On the other side, progress has been made at the state and local levels to require employers to provide paid family leave and paid sick days. If workers can take time off to deal with child care or care for sick relatives, or take days off when they are sick themselves, their average hours will probably fall. The arithmetic is striking: an increase in average time off of 2.5 days a year would reduce work time by 1.0 percent. If total hours of work needed did not change, an additional 1.4 million people would be hired in the 2016 economy. Of course, how such changes play out will never be this simple. But, as a general rule, if the average worker puts in fewer hours, we will need more workers.

The main reason for promoting measures like paid family leave and paid sick leave is to accommodate people's needs. Paid vacation should also be included in this mix, and the United States is an outlier in not guaranteeing it. Most other wealthy countries guarantee workers four to six weeks a year of paid vacation (Ray, Sanes, and Schmitt 2013), but the United States inadvertently put in place a structure of benefits that pushes workers toward taking the gains from higher productivity in the form of higher income rather than time off. There is nothing natural about this, and evidence suggests that many workers would value more leisure time even at the cost of income or less rapid income growth in the future.<sup>107</sup> But beyond these reasons, reducing average work hours spreads good jobs around more broadly and tightens up the labor market, improving workers' bargaining positions.

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107 There is also reason to believe that taking the benefits of productivity growth in leisure rather than income will have environmental benefits (Rosnick 2013).

## **The macroeconomy and everything else**

Maintaining a full-employment economy is the key element in ensuring that the benefits of growth are shared equally throughout the income distribution. However, we cannot assume that governments will always opt for progressive macroeconomic policy for reasons noted above. Furthermore, progressives may be in a position to gain power at a level where they can't set macroeconomic policy, as would be the case for state governments in the United States or the national governments within the euro zone. No progressive government should ever find itself in the situation of Syriza when it took power in Greece in 2015, with little clear agenda other than hoping Germany would grant it better bailout terms than were granted to its right-wing predecessor.

And, there is more than a little truth to the concerns of fiscal conservatives about high interest rates and/or inflation. It is certainly possible for excess demand to create a serious inflationary threat in the context of a high-employment economy, even if we have seen little evidence of this problem in the wealthy countries for the last three decades. For this reason, it is important to have policies that directly attack the source of high-end rents. Reducing the purchasing power of those at the top leaves more room for expanding the purchasing power of everyone else, without adding to inflation pressures.

## **Combating inflation by taming high-end rents**

There is no better place to begin the discussion of the politics of curbing high-end rents than the financial sector, which is the basis of many of the country's most bloated incomes. Here is it worth bringing the back the analogy of successful counterfeiters to get a better understanding of the economics.

The immediate effect of eliminating hundreds of billions of dollars of waste in the financial sector through a financial transactions tax and cracking down on abuses by the industry would be similar to the effect of shutting down a massive counterfeiting operation. The counterfeiting operation both directly employs people to print money and get it into

circulation. It also indirectly employs people based on the spending of the counterfeiters. Exposing the bills as counterfeits will put all these people out of work. Nonetheless, shutting down counterfeiters is still considered to be good economic policy. The assumption is that the people now employed as a result of the fake bills will instead be reemployed in the real economy.

Eliminating waste in finance that isn't facilitating the working of the productive economy has the same impact as shutting down counterfeiters. It should lead to clear benefits as a whole, even if there are short-term costs as people need to adjust to an economy where they are not dependent on the spending of the counterfeiters or high-flyers in the financial industry.

This can be true even in a financial center like New York City. In addition to the jobs lost by people employed in the industry, there would also be jobs loss among the hundreds of thousands of people employed serving their meals, cleaning their houses, caring for their kids, and providing a whole range of other services. But the flip side of this situation is that the demand for housing, and therefore the cost, would be dramatically reduced. Suppose that rents in the city fell by 30 to 40 percent, as the Wall Street crew was no longer able to pay outlandish prices for condominiums and apartments. This would allow many people to move to the city who might otherwise never have been able to afford it. That should provide a huge boost to other industries, since they will be able to attract more workers. Also, lower rents will free up tens of billions of dollars a year from the budgets of people who already live in the city. These people will have more money to spend on a whole range of goods and services, filling much of the gap created by the drop in spending from the Wall Street crew.

It is likely that even in the case of New York City, most people who do not work in the financial industry end up as winners by reducing the waste in the industry. It is unambiguously the case that the rest of the

country comes ahead by having less of its savings effectively taxed away by the financial industry.<sup>108</sup>

Of course, the politics of targeting waste in the financial industry will be difficult. Just as autoworkers would resist a trade pact that is likely to lead to wide-scale job loss in the auto industry, the financial industry will resist any proposal to reduce its income. But the financial industry has representatives in the places of power. Top officials in administrations of both parties are drawn from the financial industry. For Treasury Secretary, George W. Bush installed Henry Paulson, a former Goldman Sachs CEO; Bill Clinton installed Robert Rubin, also a former Goldman Sachs CEO; and Barack Obama installed Jack Lew, formerly a top executive at Citigroup. The top ranks of all three administrations were chockfull of representatives of the financial industry who would do everything in their power to block efforts to eliminate waste there. After all, we're talking about their friends' incomes, not autoworkers' paychecks.

The power of the financial industry will make it difficult to enact measures at the national level to tax financial transactions or to break up too-big-to-fail banks. But that hardly means that progressives should not continue to draw attention to the waste and high-end rents. Also, it would be possible for states with major financial centers (e.g., New York and Illinois) to impose modest financial transactions taxes on the trades that take place there. But since these trades can migrate fairly easily to other financial centers within the country, the taxes would have to be considerably lower than the levels that would be possible nationally.

It is possible to take other, more direct action at the state level to reduce other sources of waste in the sector. For example, any state (or set

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108 The prospects of London in the post-Brexit era may provide insights into the plight of a financial center after the industry has been downsized. London is virtually certain to lose jobs in the financial industry under a Brexit, but it remains to be seen whether the net effect will be positive or negative for people not working in the industry. While the media are reporting declines in house prices as bad news, the opposite is true for Londoners (or potential Londoners) who don't own a house or condo. The prospect of lower rent and the possibility of paying less for a house in the future is unambiguously good news for them.

of states) can establish a low-cost retirement system that is available for contributions from the state's workers. Illinois is implementing such a system in 2017, and California was debating a similar plan in the summer of 2016.<sup>109</sup> A national pension system would be better, but it may be necessary for a number of states to take the lead.

States may also be able to set up low-cost services in other areas to compete with the financial industry. For example, a number of proposals for a postal banking system would provide basic banking services to low- and moderate-income households (Office of the Inspector General of the United States Postal Service 2014). States may be able to follow this model, perhaps with the cooperation of the Postal Service. States may also be able to provide lower-cost auto insurance and reduce unnecessary costs associated with buying and selling homes.

In addition, state and local government can act to ensure that they are not wasting money in their pensions by paying high fees to hedge funds and private equity funds that don't produce returns that beat the market. An important step to ensure this outcome is increased transparency. All contracts entered into by these pensions should be publicly available and show what the pensions paid to hedge fund and private equity fund managers and what returns the funds received. There can be real value in setting examples. If a progressive state like Vermont or California required that all terms be public, then other states might be shamed into following the example. The same could be the case if places like San Francisco or New York City went this route. And university endowments can also provide leadership in this area. There is no excuse for throwing away public money by paying high fees to the financial industry that are not justified by the returns they produce. The first step for avoiding this situation is public disclosure.

Finally, it is important to simplify the tax code in order to reduce the size of the tax avoidance industry. Allowing firms to issue non-voting shares of stock as an alternative to paying the corporate income tax is perhaps the best way to bring about corporate tax simplification. Companies would be allowed to issue a number of shares that is roughly

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109 Illinois' law can be found in Illinois General Assembly (2015).



proportionate to the percentage of the corporate income that it expected to pay. This policy could be enacted by states that have corporate income taxes. If states followed this practice, they would likely both be reducing their own enforcement costs and setting a model that could be copied elsewhere.

If issuing shares were offered as an alternative to the corporate income tax at the national level it is difficult to believe there would not be some companies who now pay their taxes that would welcome the option of this simpler alternative. If any substantial number of companies went in their direction it could put pressure on the ones that didn't. Certainly it would be hard to explain why, if they actually are paying the taxes they owe, they would not prefer a simple mechanism that could save them a considerable amount of money in compliance costs. The first step is of course making the issuing of shares an option, which allows for the obvious question: what's wrong with giving people a choice?

### **Alternatives to patents and copyrights**

The pharmaceutical, entertainment, and software industries can be expected to fight just as hard as the financial industry to keep in place the protections that ensure their profitability. But here, too, the market is our friend.

These industries, as currently structured, depend on an incredibly inefficient system of government-imposed monopolies. These monopolies make items that would otherwise be cheap, like prescription drugs and medical equipment, incredibly expensive. They also make it expensive to get recorded music, movies, and software — all items which could otherwise be transferred at zero cost. The goal of a reform strategy is to expose the enormous waste associated with these monopolies and to find mechanisms to allow increased production and use of non-protected items. It is also important to block efforts by the government to extend the deeper reach of these monopolies to the rest of the world through trade agreements like the Trans-Pacific Partnership.

In the case of prescription drugs and medical equipment, consumers tend to have little appreciation of the extent to which patent

monopolies raise prices because they have become so used to paying high prices and are unaware that high-quality generic versions are selling in, say India, for less than 1 percent of the U.S. price. These differences are incredible both at the level of the individual drug and also at the aggregate level. It is unlikely that even many economists are aware of the hundreds of billions of dollars of additional spending on drugs, tests, and medical equipment each year as a result of their protected status. This sum is far larger than what is at stake in most policy disputes.

One way to publicize these differences is to take advantage of them. Insofar as possible, people can attempt to buy generic versions of drugs in countries where they are available. In the case of some new drugs, which are priced at more than \$100,000 for a course of treatment, it would be easy to cover the cost of an extended stay in India or other countries, bring along family members, and still have enormous savings. While this is far from an ideal way to receive medical care, it is certainly better than going without care or mortgaging a house and draining savings to cover the cost of medications. There is a basic principle that everyone should understand: drugs are cheap, but patents and other forms of protection make them expensive.

The other route is to increase the room for non-patent-supported R&D wherever possible. As noted in Chapter 5, it is not plausible that the country will flip over all at once from a system that relies on patent monopolies to one that relies on publicly funded research for prescription drugs and medical equipment. But publicly funded clinical trials could be a midway step. The government would contract with private companies, through a process of competitive bidding, to conduct clinical trials of chemicals that were either already in the public domain or to which the company bought the rights. The results would be publicly posted for doctors and researchers, and the drugs themselves would be available as generics once they had been through the FDA approval process so that anyone would be able to produce them.

This system of publicly funded clinical trials can be infinitely sliced and diced. There could public funding of trials in just some areas (for example, cancer drugs) which would require a relatively small portion of the funding now going to the National Institutes of Health. The payoff

would be both the availability of a large amount of data on the effectiveness of the trials — possibly shaming drug companies into more disclosure of test results — and the possibility that some number of important new cancer drugs would be available at generic prices. The costs of clinical tests are low enough that a major foundation or a collaboration of smaller foundations could put up the necessary funding.<sup>110</sup> If this spending produced some number of effective drugs that were made available at generic prices, it could have a considerable impact.

There are many other ways that the process can be cut. For example, the government allows drug companies a six-month patent extension when they test a drug for pediatric uses. The government could instead pay for the testing itself (making the results public) and compare the implicit cost of a six-month patent extension with the cost of direct payment.<sup>111</sup> The point here is to get a foot in the door to allow a clear basis for comparing the efficiency of directly funded research with the current system of patent monopolies. It is likely that the patent monopoly system would flunk this test. It is likely that the drug industry knows that the patent monopoly system would flunk this test, which is why they will do everything in their power to ensure that such tests don't take place. One advantage in this effort is that the generic drug industry stands to benefit from weakening or eliminating patent monopolies. Insurers, in principle, also stand to benefit from the availability of low-cost drugs as well as medical tests. Even the major pharmaceutical companies could still profit through a system of publicly funded research, since they would likely be the major recipients of contracts. However, as long as these companies can make large profits under the current system, they will be

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110 Doctors Without Borders is already engaged in a process along these lines with its Drugs for Neglected Diseases Initiative (<http://www.dndi.org/>). While this project has produced an enormous return on the money invested, it is explicitly targeted on diseases that primarily afflict poor people in the developing world. Therefore, it does little to affect thinking on the process of drug development in wealthy countries.

111 This idea was suggested to me by Jamie Love, the director of Knowledge Ecology International.

uninterested in a new route, regardless of the costs their system imposes on the country and the world.

There is a similar story on the enforcement of copyright monopolies. This is an increasingly archaic way of supporting creative work as the Internet makes it ever more difficult to prevent the transfer of unauthorized copies. This is the motivation for more punitive laws on copyright enforcement and increasing efforts to make third parties share in the cost of enforcement.

The answers in this case are both to resist repressive efforts at enforcement and to increase the availability of work not supported through copyrights. In terms of repressive efforts, the defeat of the Stop Online Piracy Act (SOPA) and the PROTECT IP Act (PIPA) were notable achievements. These laws would have required web intermediaries to police their sites for copyright violations. This is a big step up from current law, which already requires that companies side with claims by copyright holders, against their customers, and immediately remove material that is alleged to be in breach. The Trans-Pacific Partnership and other trade deals under discussion also increase the strength of copyright protection, imposing larger burdens on intermediaries.

Chapter 5 discusses a tax-credit system modeled on the charitable giving tax deduction as an alternative mechanism for supporting creative work. This can be implemented at the national level for an amount considerably smaller than the current cost of the charitable giving tax deduction. This would create a vast pool of funds to support creative work, which would almost certainly exceed the amount going to creative workers through the copyright system. As explained in that chapter, the condition for being eligible for receiving funding through the tax-credit system would be waving the right to get copyright protection for a limited period of time. This has the great virtue of being self-enforcing, since someone attempting to cheat the system by getting a copyright during their period of ineligibility would find that their claim was not enforceable.

While such a system could produce a large amount of creative work if it were implemented nationally, states or local governments could experiment with a similar tool. Suppose a city of 200,000 made available a

credit of \$50 per adult. To be eligible for the credit, a creative worker would not only have to forego copyright protection for a period of time, but he or she would also have to physically live in the city for at least eight or nine months of the year. Donations by three quarters of the population (a high share, but it's free, since the donor gets a full tax credit) would create a pool of \$7.5 million to support creative workers.

Since these workers would be required to live in the city much of the year, they would have an incentive to perform their music or plays, conduct writing workshops, or perform other work that would both support them and increase their visibility to people deciding what to do with their tax credit. It is easy to envision a scenario in which this sort of influx brings in enough tourist revenue to more than cover the cost of the tax credit. Of course, this would be an easier proposition if a creative foundation were prepared to put up part of the cost.

In any case, this and many other mechanisms can increase the supply of material supported outside of the copyright system. As more free material becomes available, it will be more difficult and irrelevant to maintain copyright as we know it.

### **Reining in CEO pay: Getting corporations to serve their shareholders**

Chapter 6 noted the explosion in CEO pay over the last four decades and argued that this was the result of a failed corporate governance structure, rather than the increased value that CEOs were providing to shareholders. The argument is that the corporate directors who most immediately determine CEO pay largely owe their jobs to top management. They have little incentive to ever challenge a CEO pay package since they risk angering the CEO and their fellow board members by pressing the issue. In contrast, virtually no director ever loses their job because of allowing an excessive pay package for CEOs and top management.

Insofar as this story accurately describes the rise in CEO pay, the appropriate political strategy involves making it easier for shareholders to exercise control over the company they are supposed to own. Chapter 6

proposes changes to corporate governance that alter the structure of incentives for corporate directors. For example, the directors could lose their annual stipend if a CEO pay package is voted down in a say-on-pay vote by shareholders. The pay for directors can also be structured in ways that give them a direct incentive for holding down CEO pay. For example, the directors can be allowed to share half of the savings from cutting CEO pay, as long as the company's stock performance was not harmed.

While changes in corporate governance rules could be implemented through Congress, this is not likely to happen anytime soon. However, it would be reasonable to push some changes as voluntary measures. For example, less than 3 percent of CEO pay packages are rejected by shareholders. This means that asking directors to voluntarily agree to an arrangement where they would surrender their pay in such cases is simply asking for a vote of confidence that they will not be in the bottom 3 percent of corporate boards. This is a rather low bar.

This also could be a situation where a few examples could prove very powerful. If the board of a major corporation accepted a rule whereby it agreed to forfeit its pay in the event that a say-on-pay initiative were defeated, it might shame other boards into following its lead. After all, why are these boards collecting their large salaries if they can't hold CEO pay to reasonable levels?

The other part of this chapter dealt with the run-up of pay of top executives in the nonprofit sector, which has paralleled the run-up in CEO pay. While the top executives of major universities and foundations are not getting paychecks in the tens of millions of dollars a year, it is not uncommon for their pay to cross \$1 million, or more than 25 times the pay of the typical worker. As was noted in the chapter, this pay is largely subsidized by taxpayer dollars, since donations to these institutions are tax-exempt. This means that roughly 40 percent of their salaries came from taxpayers. In the case of a foundation or university president getting \$1 million a year, effectively \$400,000 is coming from taxpayers.

If taxpayers are paying the bill, it is reasonable to put limits on the top salaries that these institutions can pay. The President of the United States is paid \$400,000 a year, which seems like a fair limit on the pay of people employed by tax-exempt institutions. Just to be clear, this is not

limiting what nonprofit institutions can pay their presidents or other top officials. It is only limiting what they can pay them while getting a subsidy from taxpayers. This is a measure that also can be put in place at the state level. While the most important tax subsidy is allowing contributors to write off the donation on their taxes, most states exempt nonprofits from paying sales taxes and often property taxes. They could in principle make eligibility for this special tax treatment contingent on accepting limits on pay. As a practical matter, it is unlikely that states would have to worry much about nonprofits fleeing. Harvard is unlikely to leave Massachusetts even if it were forced to reduce its president's pay to \$400,000 a year — the salary of the President of the United States — as a condition of special tax treatment.

Pressure on individual institutions by students, faculty, and alumni could prove effective. And some schools going this route would put pressure on others to follow. The fruit of lower pay for those at the top is lower tuition costs and more money available for other employees.

### **Protectionism for high-paid professionals**

The last major form of rent discussed in this book is the pay of highly educated professionals, like doctors, dentists, and lawyers. These professionals are paid far more than their counterparts in other wealthy countries. As noted in Chapter 7, if doctors in the United States were paid the same as their counterparts in other wealthy countries it would save roughly \$100 billion a year in health care costs.

It's not an accident that the pay of these workers has not been put under pressure by globalization. It was the result of deliberate policy decisions to largely protect these highly educated workers from foreign and even domestic competition. In the case of doctors, foreign-trained doctors are largely excluded from practicing medicine in the United States.

The issues with domestic forms of protection in highly paid professions are likely to become more serious as technology makes it possible for many relatively complex tasks to be performed by professionals with lower levels of training. For example, advances in

diagnostic technology may allow nurse practitioners to make diagnoses of most conditions with the same or better accuracy than most doctors. However, if doctors are allowed to determine standards of care, then they are likely to leave in place regulations that effectively force people to see general practitioners or even highly paid specialists when a much lower paid professional could perform the work equally well.

If our trade negotiators treated doctors and other highly paid professionals the same way they treated manufacturing workers, then trade agreements would have been written to make it as easy as possible for smart, ambitious kids in Mexico, India, and other developing countries to study to meet U.S. standards. They then would be able practice their profession in the United States in the same way as someone born and educated in the United States. The fact that manufacturing workers face competition from low-paid workers in the developing world and doctors and other highly paid professionals don't has nothing to do with the inherent dynamics of globalization: it is about the differences in the power of these groups.

Ideally, we would start to change trade deals so that we did see this sort of competition at the high end. It would lead to the same sorts of gains from trade that we get from buying cheaper clothes and car parts from abroad. However, in this case, the impact would be to reduce inequality rather than increase it.

It is not likely that our trade agenda will be taken over by avid free traders anytime soon, but there are other mechanisms that can help to bring about similar outcomes. One is measures that make it easier for patients to take advantage of the lower prices for major medical procedures in other countries. There are many high-quality facilities in countries like India that charge prices that are often less one-tenth the prices in the United States. Since the cost of some of these procedures runs into the hundreds of thousands of dollars in the United States, and they are usually not done on an emergency basis, patients could travel for their surgery (and even bring along family members) and still have large savings.

While this practice is not likely to be promoted at the national level due to the power of the doctors' lobby, there is no reason that a state



couldn't take advantage of this opportunity for cost savings. States could offer their Medicaid patients the option to get major operations overseas, while splitting the savings, as an alternative to having procedures done in the United States. They could also write rules for insurers to facilitate such arrangements. In addition, a solid international licensing system for medical facilities would be helpful for ensuring quality standards, as would clear rules on malpractice. Allowing more people to take advantage of low-cost health care in other countries will directly put downward pressure on prices in the United States by reducing demand. It can also have the beneficial political effect of allowing people to see first-hand that the quality of care in many other countries is comparable to that in the United States.

In principle, it would be possible to make similar arrangements with Medicare. The cost of providing health care to our retirees is more than twice as much per person as in other wealthy countries. This creates the potential for large gains if Medicare beneficiaries are given the opportunity to use their Medicare to buy into health care systems in other countries. The gap between the cost of providing care under the Medicare system and the cost of providing health care through another country's health care system could be shared between the beneficiary and the U.S. government. This would also reduce the demand for domestic medical services while educating people about the quality of health care in other countries.

Here also the doctors' lobbies will furiously fight the idea of globalizing Medicare. While it would be hard to overcome their resistance, it is a case where the doctors are clearly the enemies of globalization and relying on old-fashioned protectionism to maintain their bloated pay. If doctors were treated the same way as textile workers and autoworkers in trade pacts, they would face massive job loss and plunging paychecks.

There are similar, if less dramatic stories, with the other highly paid professions. There are enormous potential gains from opening them up to international competition. It is only the political power of these relatively highly paid workers that prevents them from being subject to the

same sort of international competition as their less highly paid counterparts.

### Adding it all up

All of the changes outlined in the previous chapters are not likely to happen anytime soon. But the point of this book is that the distribution of income can be hugely altered by restructuring the market to produce different outcomes. This doesn't dismiss the value of tax and transfer policies, but if the market is rigged to redistribute ever more income upward, it will be difficult to design tax and transfer policies to reverse this effect. And if the rigging efforts are never challenged, then they will impose an ever greater burden on those trying to reduce inequality through tax and transfer policy.

**Table 8-1** shows the range of the gains from restructuring the market. The total comes to almost \$2 trillion in additional income in 2016 in the low-end case, \$3.7 trillion in the high-end case. Expressed as units of SNAP spending (**Figure 8-1**), the low-end amount is equal to 27.1 units and the high-end amount just under 50. In short, there is a lot of money at stake here.

This calculation requires several important qualifications. First, more than half of these potential gains are associated with full-employment policy. The high-end number is based on a projection of GDP that assumes the 2008 crash either never happened or that we responded to it quickly and aggressively enough to quickly restore GDP back to its potential. Of course, that didn't happen, and we can't rewrite the past. The result of the crash and subsequent policy failures has to been to permanently reduce potential GDP, both as a result of a lower capital stock and also due to some people likely permanently leaving the labor force. The lower figure, which assumes that we can make up half of the gap between the pre-crash projection of potential GDP and actual output, is more realistic but still optimistic.

The second qualification is that not all of this money would be transferred from the rich to everyone else. For example, if we increased GDP back to its potential, some of the gains would go the 1 percent. And

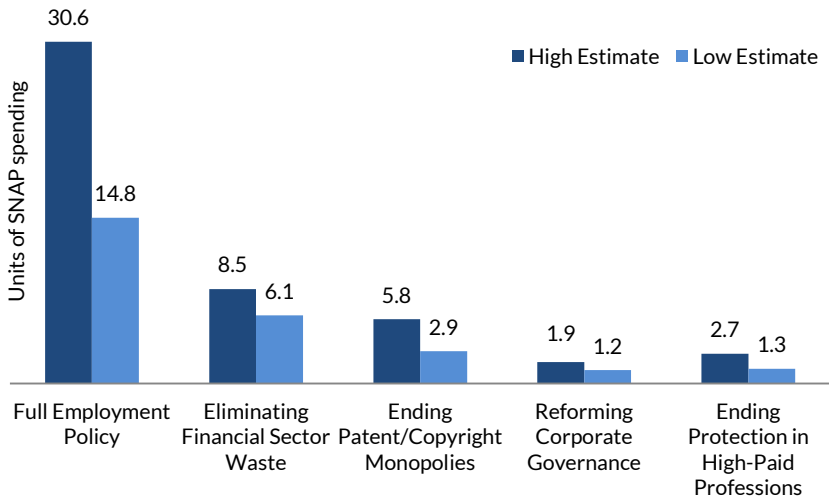
even if a disproportionate share of the additional output from getting back to full employment goes to people lower down on the income distribution, the share going to the top 1 percent will not be zero. The same would hold true for all of the potential gains from eliminating rents. Not all the benefits will go to those lower down in the income distribution, even if the bulk does.

**TABLE 8-1****Gains from restructuring markets**

(billions of 2016 dollars)

	Low	High
Adopting a full-employment policy	\$1,115	\$2,300
Eliminating financial sector waste	\$460	\$636
Ending patent/copyright monopolies	\$217	\$434
Reforming corporate governance	\$90	\$145
Ending protection of highly paid professions	\$100	\$200
<b>Total</b>	<b>\$1,982</b>	<b>\$3,715</b>

Source and notes: Author's calculations; see text.

**FIGURE 8-1****Gains from restructuring markets, in units of SNAP spending**

Source and notes: Author's calculations; see text.

Finally, there is likely to be some interactive effect that would go in the right direction from the standpoint of reducing inequality. For example, more than 470,000 physicians are specialists in the United States (Kaiser Family Foundation 2016), and the vast majority earn over \$250,000 a year. They account for roughly a quarter of high-end earners in the United States (SSA 2016b). Reducing the ratio of specialists to primary care physicians down to the level that holds in other countries and bringing their average pay down closer to \$200,000 (also more in line with other wealthy countries), would put downward pressure on the wages of high-end earners more generally. A sharp reduction in the number of high-paying jobs would have a substantial impact on the high end of the labor market just as the loss of manufacturing jobs has an impact on the labor market for non-college-educated workers more generally. For this reason, some of the estimates in Table 8-1 may actually understate how much eliminating rents may reduce income inequality.

For all the qualifications, there should be little doubt that there is potential to have a large impact on the distribution of income through economically plausible restructurings of the market. The gainers in the top 1 percent have structured the market over the last four decades in ways that increase their share of income. This restructuring can be reversed.

# Chapter 9

## Rewriting the Narrative on Economic Policy

The standard framing of economic debates divides the world into two schools. On the one hand, conservatives want to leave things to the market and have a minimal role for government. Liberals see a large role for government in alleviating poverty, reducing inequality, and correcting other perceived ill-effects of market outcomes. This book argues that this framing is fundamentally wrong. The point is that we don't have "market outcomes" that we can decide whether to interfere with or not.

Government policy shapes market outcomes. It determines aggregate levels of output and employment, which in turn affect the bargaining power of different groups of workers. Government policy structures financial markets, and the policy giving the industry special protections allows for some individuals to get enormously rich. Government policy determines the extent to which individuals can claim ownership of technology and how much they can profit from it. Government policy sets up corporate governance structures that let top management enrich itself at the expense of shareholders. And government

policy determines whether highly paid professionals enjoy special protection from foreign and domestic competition.

Pretending that the distribution of income and wealth that results from a long set of policy decisions is somehow the natural workings of the market is not a serious position. It might be politically convenient for conservatives who want to lock inequality in place. It is a more politically compelling position to argue that we should not interfere with market outcomes than to argue for a system that is deliberately structured to make some people very rich while leaving others in poverty.

Pretending that distributional outcomes are just the workings of the market is convenient for any beneficiaries of this inequality, even those who consider themselves liberal. They can feel entitled to their prosperity by virtue of being winners in the market, yet sufficiently benevolent to share some of their wealth with the less fortunate. For this reason, they may also find it useful to pretend that we have a set of market outcomes not determined by policy decisions.

But we should not structure our understanding of the economy around political convenience. There is no way of escaping the fact that levels of output and employment are determined by policy, that the length and strength of patent and copyright monopolies are determined by policy, and that the rules of corporate governance are determined by policy. The people who would treat these and other policy decisions determining the distribution of income as somehow given are not being honest. We can debate the merits of a policy, but there is no policy-free option out there.

This may be discomfoting to people who want to believe that we have a set of market outcomes that we can fall back upon, but this is the real world. If we want to be serious, we have to get used to it.