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Introduction

THE CRISIS OF THE LIBERAL ORDER

The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist.

—JOHN MAYNARD KEYNES, *THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY*, 1936

The Berlin Wall fell when one of us was just starting preschool and the other was beginning his career, that moment was crucial in shaping our political identities. The “American way”—free markets, popular sovereignty, and global integration—had vanquished the Soviet “evil empire.” Since then those values—which we will call the liberal order—have dominated intellectual discussions. Leading thinkers declared “the end of history.”

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The great social problems that had so long been the center of political drama had been solved.¹

Both of us came of age intellectually in an unprecedented era of global intellectual consensus, confidence, and complacency. Nowhere was this atmosphere clearer than in the policy world in which we each ended up—one of us in law, the other in economics. Ironically, economics, more than any other field, took on the mantle of leadership in a world where debates over economic systems had disappeared. Economists, who at one time had helped define the extremes of the political spectrum (remember Karl Marx?), saw themselves as mainstream voices of reason, entrusted by the public with policy decisions.²

In universities and professional associations, economists focused on centrist policy analysis, which, being highly mathematical and quantitative, appeared to be ideologically neutral. Meanwhile the field marginalized those on the radical left (Marxists) and right (the so-called Austrian school).³ Most of the work done by academics in the areas of economics, law, and policy were devoted to justifying existing market institutions or offering moderate reforms that, in essence, preserved the status quo.

With few exceptions, mainstream economists of this era assumed that the prevailing design of market institutions was working about as well as possible. If markets “failed,” the theory went, moderate regulation, based on cost-benefit analysis, would pick up the slack. Questions about inequality were largely ignored. Economists believed that because markets generated so much wealth, inequality could be tolerated; a social safety net ensured that the worst off didn’t starve. One of us ended up working at Microsoft, pursuing his interest in extending the standard approach to modern technology plat-

forms, and the other focused on questions of legal reform. Meanwhile, the ground was shifting beneath our feet.

The financial crisis of 2008 and the subsequent recession were the first tremors. Yet even though the economic downturn was the worst since the Great Depression, for a time it seemed to be no different from most recessions. People lost their homes, jobs, and access to credit, but this had happened many times before and the economy had recovered. Only in 2016 did it become clear how dramatically things had changed.

It turned out that a great deal of the economic progress that had taken place before the recession was illusory—it had benefited mostly the very rich. Ballooning inequality, stagnating living standards, and rising economic insecurity made a mockery of the old style of policy analysis. The angry political reaction to the recession—exemplified in the United States by the Occupy Wall Street and Tea party movements—did not subside as the economy recovered. The public lost faith in the mainstream policy analysis of elites who had supported financial deregulation and then the unpopular bailouts. With the old ways of doing things in doubt and new directions unclear, public opinion polarized. And because of long-simmering controversies over cultural issues, especially immigration, anger at the elites took an ugly nativist turn. Xenophobia and populism at a level not seen since the 1930s erupted across the world.

Unfortunately, ideas have not kept up with the crisis. Capitalism is blamed for increased inequality and slowing growth, yet no alternative has presented itself. Liberal democracy is blamed for corruption and paralysis, but authoritarianism is hardly an appealing substitute. Globalization and international governance institutions have become favorite scapegoats, yet no other sustainable path for international relations has been

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proposed. Even the best-run governments of the most advanced countries rally around the mainstream technocratic approach of the past despite its many failures.

In searching for a way out of this impasse, we have thus found ourselves rereading the works of the founding fathers of modern social organization: a group of self-styled “political economists” and “Philosophical Radicals” of the late eighteenth and nineteenth centuries, including Adam Smith, the Marquis de Condorcet, Jeremy Bentham, John Stuart Mill, Henry George, Léon Walras, and Beatrice Webb.

Although these thinkers—whose ideas we will explore in later chapters—lived in a world different from ours, they faced some similar challenges. The economic and political system they had inherited from the eighteenth century could not keep up with changes in technology, demographics, the globalization of the time, and the larger cultural environment. Entrenched privilege blocked efforts to promote equality, growth, and political reform. Believing the intellectual resources of the day were insufficient to provide a way forward, the Philosophical Radicals developed new ideas that have played an enormous role in the development of our modern market-based economic system and of liberal democracy. Their vision and reforms combined the libertarian aspirations of today’s right with the egalitarian goals of today’s left and are the shared heritage of both ends of the standard political spectrum. This is the common spirit we seek to revive.

Inequality

The most significant problem of our time is the rising inequality within wealthy countries. Figure I.1 shows the evolution of the share of income earned by the top 1% of the income distribution in the United States from 1913 to 2015.⁴ The figure

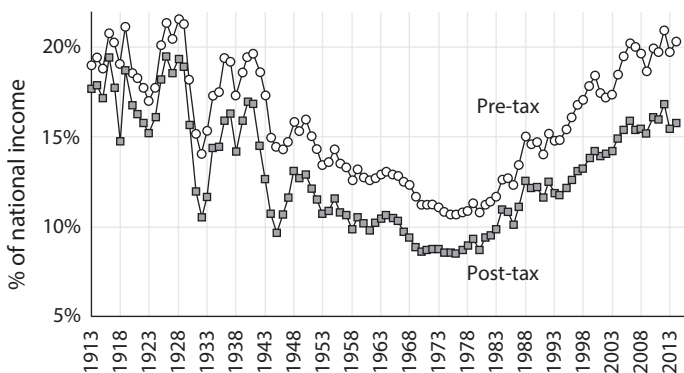


FIGURE I.1: US income shares of top 1% households, including capital gains, before and after taxes.

Source: Thomas Piketty, Emmanuel Saez, & Gabriel Zucman, *Distributional National Accounts: Methods and Estimates for the United States*, *Quarterly Journal of Economics* (Forthcoming).

shows this share both before and after taxes. Focusing on the after-tax figure most relevant to final consumption, we see that the share of income taken by the top 1% of earners has roughly doubled from its trough of 8% in the mid-1970s to its recent peak of 16%. A similar pattern, though less dramatic, prevailed in many other Anglo-Saxon countries during this period. Income patterns were more muted in some continental European and East Asian countries where government redistribution is more generous.⁵

Is this growth in inequality simply the price of a dynamic economy, as suggested by many “neoliberal” economic arguments? Some economists have argued that growing inequality reflects the diverging skills and opportunities of the talented, skills that will go to waste if not rewarded by rising income. Yet rising inequality does not reflect only diverging wages, but the shift of national income away from wages entirely. Figure I.2 shows the share of national income that accrues to all labor, from factory workers to CEOs, what economists call the “labor

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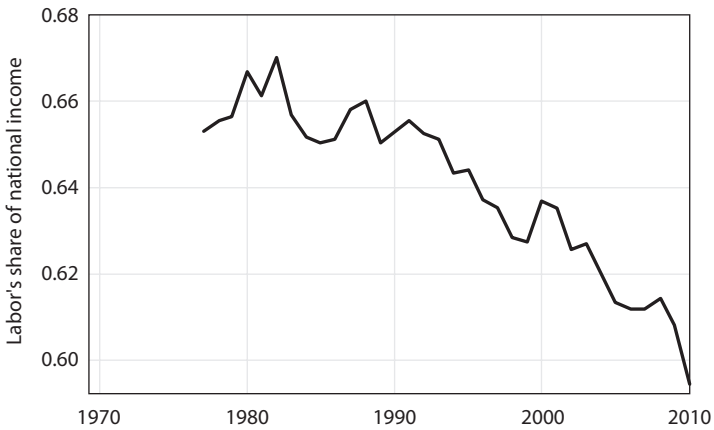


FIGURE I.2: Labor's share of US national income over time.

Source: David Autor, David Dorn, Lawrence F. Katz, Christina Patterson, & John Van Reenen, *The Fall of the Labor Share and the Rise of Superstar Firms* (MIT Working Paper, 2017), <https://economics.mit.edu/files/12979>.

share.” There has been a nearly 10% drop over this same period in the share of national income in the United States that rewards work, bringing the United States closer to developing countries where labor’s share is far lower than has traditionally been the case in rich countries.

Where has the money that used to pay workers gone? If it were rewarding saving, that might not be so worrying. After all, any citizen can choose to save, and rewarding saving can stimulate growth. Yet increasing evidence suggests that the reward to saving is itself falling (as evidenced by falling interest rates) and instead an increasing fraction of national income is being absorbed by market power—what we later call the “monopoly problem.”⁶ Figure I.3 illustrates the trend.

The top panel of figure I.3 shows the share of US national income accounted for by “economic profits” above what would be expected under perfect competition, profits attributable to monopoly power. Such excess profits have risen roughly four-

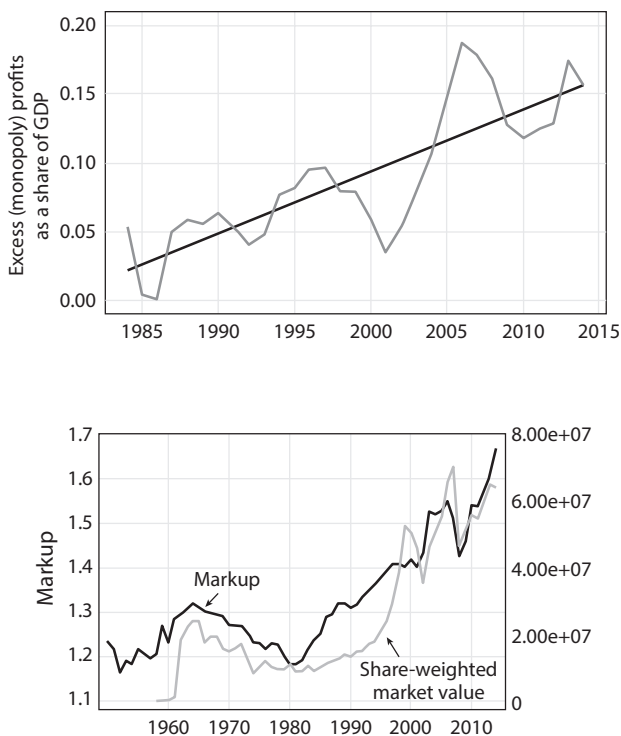


FIGURE 1.3: Above—competitive profits as a fraction of national income in the United States over time. Below—markups over cost (black) and average share-weighted stock market value (gray).

Sources: Simcha Barkai, *Declining Labor and Capital Shares* (2017), <http://home.uchicago.edu/~barkai/doc/BarkaiDecliningLaborCapital.pdf>, and Jan de Loecker & Jan Eeckhout, *The Rise of Market Power and Macroeconomic Implications* (2017), <http://www.janeeckhout.com/wp-content/uploads/RMP.pdf>.

fold just since the early 1980s, in tandem with rising inequality and declining labor share.⁷ These profits are overwhelmingly claimed by the extremely wealthy. As we argue below, the rise in inequality and the fall in labor's share are both fueled by and fuel a rich-get-richer dynamic. Sixty percent of the income of the top 1% of earners comes from such profits or returns on capital (as opposed to wages), four times as large a fraction as

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for the bottom 90% of income earners. The bottom panel of the figure shows the co-evolution of another measure of market power (the excess price or “markup” firms charge over cost) and the stock market value of corporations.⁸ The close coincidence of these series, and the tight correlation the authors found between market value and markups across companies in a given year, strongly suggest that falling labor’s share and rising inequality are not simply the necessary consequence of accelerated growth. Instead, they are close correlates (symptoms, causes, or likely both) of increased market power.

The trajectory of inequality *across* countries is a different story. Figure I.4 shows the fraction of global inequality, measured by the common “mean logarithmic deviation” (discussed further in chapter 3), that prevailed between, rather than within, countries from 1820 to 2011. From 1820 to 1970, inequality between countries grew nearly tenfold; in contrast, inequality within countries declined by about a fifth. This pattern has reversed since 1970; international inequality has fallen by about a fifth and domestic inequality within wealthy countries has risen.

Again, if this international inequality were an outgrowth of dynamic international markets, it might be worth its price. Yet, the fact that international inequality began to fall just as globalization began to accelerate and decolonization was completed suggests that international inequality may be attributable to colonialism and closed international markets rather than to free markets.

Stagnation

The last significant shift in economic philosophy took place in the 1970s, when “stagflation” (simultaneously high inflation

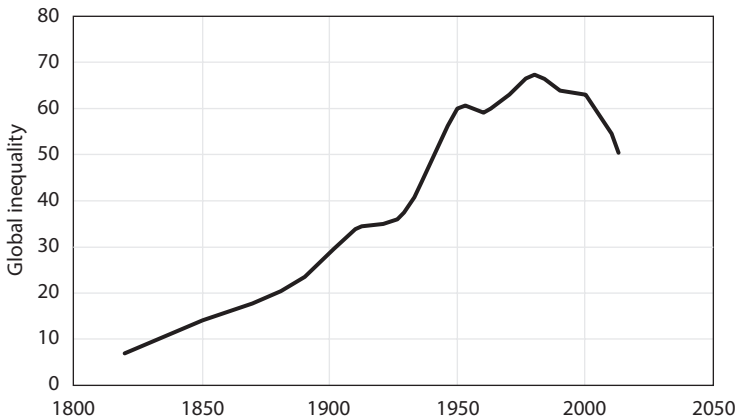


FIGURE 1.4: Global inequality that is across as opposed to within countries from 1820 to 2011, measured by the mean logarithmic deviation (see chapter 3).

This series is based on a merger of the data of François Bourguignon and Christian Morrisson, *Inequality Among World Citizens: 1820–1992*, 92 *American Economic Review* 4 (2002), and Branko Milanovic, *Global Inequality of Opportunity: How Much of Our Income Is Determined by Where We Live?*, 97 *Review of Economics & Statistics* 2 (2015), performed by Branko Milanovic as a favor to us.

and unemployment) undermined the then-accepted Keynesian argument that inflation was a cost worth paying for full employment. The neoliberal and “supply-side” ideas that grew up in response promised that allowing greater play of capitalism (lower taxes, deregulation, privatization) would unleash economic growth. Even if capitalism might cause some inequality, wealth would eventually “trickle down” to ordinary workers. Yet not only has the promised wealth failed to trickle down; it has not materialized at all. In fact, productivity growth has dramatically fallen over this period. For example, in the United States, the growth in labor productivity from the end of World War II until 2004 was around 2.25% annually. Since 2005, productivity growth has slowed by a full percentage point, to around 1.25%.⁹

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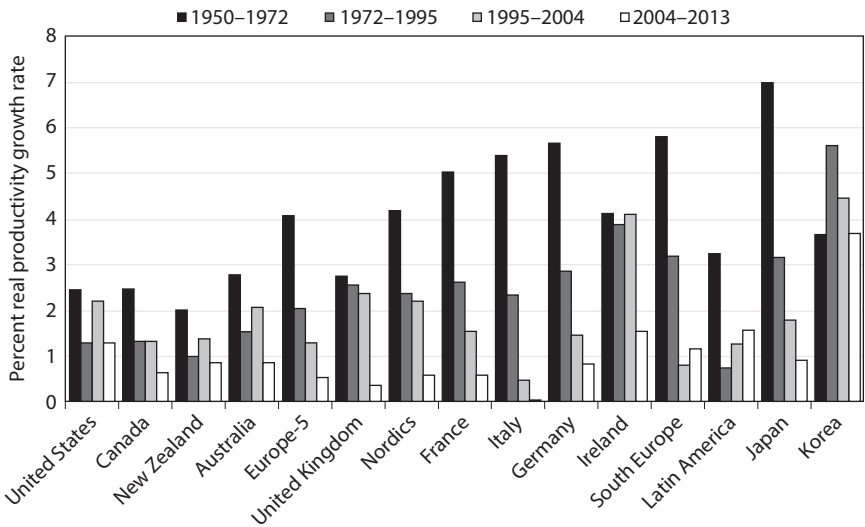


FIGURE I.5: Average annual real productivity growth around the world for various regions or countries and time periods, 1950–2013.

Source: OECD.

This phenomenon has been less dramatic in the United States than in other wealthy countries. Figure I.5 shows productivity growth in countries around the world beginning in 1950.¹⁰ Overall, productivity growth has dramatically fallen since midcentury, with the exceptions of the 1995–2004 period in certain wealthy countries and the different trend observed in developing countries. In many wealthy countries, such as France and Japan, productivity growth fell by a factor of 10, from 5% to 7%, respectively, during the period from 1950 to 1972 to just a fraction of a percentage in the past decade. Recent data paint an even more discouraging portrait.¹¹

A related problem concerns the key economic resources of labor and capital, which are marked by widespread unemployment (in the case of labor) or misallocation (in the case of capital). This aspect of sluggish economic growth has indepen-

dent significance because unemployment and low wages cause social and political conflict. Unemployment and misemployment differ from country to country, depending on the treatment of the long-term unemployed. In Europe, unemployment rates have risen, while in the United States, prime-aged males are dropping out of the labor force. For example, the labor force participation rate of prime-aged US men fell from 96% in 1970 to 88% in 2015. In most countries in Europe, unemployment has risen from rates of 4% to 6% midcentury to a persistent 10% or higher rate.¹² And it is not only labor that is underused in today's economy. Recent research indicates that capital assets are misallocated across firms as well, in the sense that capital is not employed by the firms, sectors, or cities that could make the most valuable use of it.¹³ This suggests that reallocating capital and employment from less productive entities to more productive ones could dramatically increase aggregate output.¹⁴

Together, the trends of rising inequality and stagnating growth mean that typical citizens in wealthy countries are no longer living much better than their parents did. Economist Raj Chetty and co-authors found that while 90% of American children born in 1940 had a higher living standard than their parents, only 50% of children born in 1980 did.¹⁵ Similar figures are not yet available for other wealthy countries, but these patterns likely characterize them as well.

These trends pose the same problem for the neoliberal economic consensus that stagflation posed for the Keynesian consensus before it. We were promised economic dynamism in exchange for inequality. We got the inequality, but dynamism is actually declining. Call it *stagnequality*—lower growth combined with rising inequality rather than inflation. It is no surprise, then, that the public has rejected conventional economic wisdom.

Conflict

Given that leftists have long criticized “trickle-down economics,” it would be natural to expect a leftist populist backlash to stagnation and a subsequent move to redistribute income. To some extent this prediction has been confirmed by recent events, as summarized in table I.1. Bernie Sanders nearly won the US Democratic primary despite identifying as a socialist earlier in his life and running for president as a social democrat. In the UK, Labor party leader Jeremy Corbyn is the most left-wing leader of Britain’s Labor party with a serious chance of victory in becoming prime minister since World War II, and left-wing movements in France and Italy have achieved unusual political success.

However, history has shown that fascist or ultranationalist movements have come to power when the social fabric is fraying. Promising to claim wealth for the masses, not from the rich, but from an external enemy or from an internal “other,” a vulnerable minority group, reactionary movements often turn their fury outward, threatening international stability. Although discredited for a time by the Holocaust and World War II, there are troubling signs of their revival.

As table I.1 shows, rightist movements have gained greater traction at ballot boxes and in achieving political goals than have leftist movements.¹⁶ In the United States, the UK, and Russia these movements have either taken control of government, achieved significant influence over government, or achieved concrete political ends. In France and Italy, they have come close. One has to reach far back in the history of the countries they affect to find a precedent for them. Japan, France, Germany, Italy, and Australia have not seen such movements gain this level of success since World War II. While the United States has a rich populist tradition, Donald Trump is

TABLE 1: Anti-establishment, illiberal, and populist movements in the ten largest economies in the world with above-average living standards, ordered in descending size, by 2016 International Monetary Fund nominal Gross Domestic Product

Country	Leftist movement	Recent electoral standing	Rightist movement	Recent electoral standing	Historical precedents
United States	Bernie Sanders	Near-victory in Democratic primary	Donald Trump	Won presidency	Unprecedented since at least Civil War
Japan	None		Nationalism and militarism within ruling party	Prime minister has close ties to far Right	Unprecedented since WWII
Germany	None		Alternative for Germany (AfD)	Third largest party	Unprecedented since WWII
United Kingdom	Jeremy Corbyn's Labor party	Near victory in 2017 general election, leads in polls	Brexit, UK Independence party, Theresa May	Won national referendum, swayed Conservative party close to their views	Unprecedented since WWII
France	Unsubmissive France	Fourth place in first round of presidential election	National Front (FN)	Second place in presidential election	Unprecedented since WWII
Italy	Five Star Movement	Leading recent opinion polls	Five Star Movement, Northern League	Leading, third in recent opinion polls	Unprecedented since WWII
Canada	None		None		
South Korea	None		None		
Russia	None		Vladimir Putin	Control of state since late 1990s	Leonid Brezhnev in early 1980s
Australia	None		Pauline Hanson's One Nation	Fourth largest party	Unprecedented

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the first true populist president, a man with no experience in political or military office. Trump attacked fundamental political institutions with incendiary language on the campaign trail and in office, something no other president has done, with Andrew Jackson as the arguable exception.¹⁷

Right-wing populist movements appeal to historically dominant population groups that have been left behind economically relative to their expectations: the poorly educated, those who live in rural areas, and workers who have lost jobs because of international trade.¹⁸ Arguments made by the leaders of right-wing populist movements for trade barriers and immigration restrictions fall on willing ears. But rather than explicitly appeal to class identity or distributive justice, the leaders of right-wing populist movements appeal to the ethno-nationalist creed of “blood and soil.” These groups look nostalgically back to a past when people like them enjoyed greater economic security and higher status.

Right-wing populist movements bring out into the open the underlying problems with the systems they challenge. They simultaneously reflect and further heighten the high levels of political polarization, threatening the political stability of democratic countries.¹⁹ The movements offer little in terms of realistic policy proposals that would benefit their members as well as the general public; they are protesting against the failures of existing political systems rather than acting as a positive force.²⁰ The rise of these movements, then, reflects a failure of democratic institutions to advance the public interest and resolve conflicts between different social groups.

Today’s right-wing movements come into conflict with those who do not share their narrowly defined identity. White, male, working-class earnings are stagnating in wealthy countries, while women, ethnic and racial minorities, and people in

developing nations are enjoying relative advances.²¹ Rightist leaders blame the economic success of minorities for the problems that are oppressing working-class white men and promise that “taking back” the increased wealth of poor countries will solve them.

Within wealthy countries, movements assert rights for women and a variety of minorities. In developing countries, nationalistic movements of another sort have been gaining strength. Many rising powers (China, India, Turkey, Mexico) have seen an increase in authoritarian and nationalist sentiment, driven in many cases by leaders accusing Western-dominated international institutions of holding back their countries. A collision seems to be looming between the demands for economic progress in developing countries and the increasingly nationalistic politics of wealthy countries.

Many of these domestic and international political conflicts relate to the difficulty of democratically resolving issues that pit the fundamental concerns of minority groups against the less pressing interests of majority groups. These issues have important economic foundations but are often formulated in social and cultural language that clearly marks the right-wing leader as being on the side of a particular group.

In the United States, for example, gun rights, religious liberty, and the right of the wealthy to contribute to political campaigns animate the Right, while the identity politics of minority groups and civil liberties inspire the Left. Attempts to resolve these issues often end up in the hands of the judicial system. But judges are members of the elite and tend to be out of touch with what life is like for many ordinary citizens. Their decisions often inflame rather than settle cultural disputes.

On the international stage, institutions, such as the World Trade Organization and the European Union, which were

designed to help resolve the tensions between national sovereignty and international order, are increasingly seen as illegitimate, unresponsive, and unable to balance the interests of richer and poorer countries. In short, governance institutions around the world face a crisis of legitimacy.

The Markets and Their Discontents

The heroes of our story, the Philosophical Radicals, came to prominence in the face of a constellation of woes closely related to those we are seeing today. They saw aristocratic privilege restraining markets as the problem. Their goals were to free markets from the control of feudalistic monopolists whose hoarding of land impeded productivity and concentrated wealth; to create political systems responsive to popular sentiment and able to resolve internal conflict; and to establish an international system of cooperation that would benefit the general population of countries and undermine traditional elites. This is precisely the sort of movement that our present crisis calls for.

The spirit of the market form of organization appears most famously in the late-eighteenth-century writings of Adam Smith. Smith saw markets as settings where “It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.”²² While now a cliché, the notion that self-interested behavior led to the public good was shocking at the time because it contrasted so sharply with common experience.

In the past, most individuals lived their lives within small, tight-knit communities where moral impulses, social shame, gossip, and empathy provided the primary incentives for individuals to accommodate themselves to the common good. Economists and sociologists sometimes call these communi-

ties “moral economies.”²³ Self-interested behavior was of course common and unavoidable but was regarded as an unfortunate consequence of the fallen nature of human beings rather than as a source of prosperity. Religion served to constrain such deviance at every turn. The virtuous were farmers, craftsmen, soldiers, and valiant aristocratic warriors, who followed an age-old way of life for its own sake or to please God. Merchants, financiers, and others who amassed wealth from “commerce” were regarded with suspicion well into the nineteenth century.

Even today, moral economies flourish in approximate form outside the cities and govern our relationships with close friends and family. An idealized portrait of such a society is Frank Capra’s 1946 classic film *It’s a Wonderful Life*. George Bailey (played by Jimmy Stewart) is a banker motivated less by profit than by the needs of his small community, which he is able to serve thanks to his intimate knowledge of his fellow townsfolk. When trouble comes with the onset of the Great Depression, the community reciprocates his altruism and saves him and his bank from ruin. Smithian capitalism—embodied by a greedy, amoral competitor, Mr. Potter, who finances slums and exploits his customers—is portrayed as a threat to the community. The sense of mutual support between Bailey’s bank and the town attests both to the economic efficiency of the moral economy and its intrinsic value.

Smith’s critics have emphasized the real advantages of moral economies over markets.²⁴ Market prices cannot detect, account for, reward, or punish the many ways in which individual actions affect others. In a market economy, if a homeowner beautifies her house, she raises the value of her neighbor’s property, but the market rewards her only for the increase in her own home’s value, not for the benefits to her neighbor. In a moral economy, the same homeowner would be rewarded

by her greater standing in town and the appreciation of her neighbors, who will reciprocate in some way. In a market economy, a business that sells defective products may eventually suffer some reputational costs, but usually will profit for years. In a moral economy, the business owner would be run out of town. Governments try to step into the shoes of the village gossip, but the regulations and rulings their bureaucrats and judges hand down are never as responsive to local conditions as community members are.

Despite these advantages, moral economies break down as the scope and scale of trade expand. We benefit from mass production and global supply chains because fixed costs of production are spread over millions of people and we can draw on diverse skills and inputs from around the world, resulting in delightful products at very low prices. But if millions of people worldwide consume a product, it is impractical for them to coordinate a boycott—except in unusual cases—if the product is hazardous or of low quality. Moreover, mass production requires merchants to trade over long distances, with strangers, and this means that personal reputation cannot ensure that contracts are kept. A modern market economy—which combines government support for trade (contract and property law) along with government protection against abuses (tort law and regulation)—generates value far beyond the capabilities of a moral economy. Because of these limitations, moral economies can feel constraining and antiquated when confronted with large-scale market societies. Unable to account for the needs of those far away, they may become hostile to outsiders and intolerant of internal diversity, fearing it will erode group values.

From *The Scarlet Letter* to *Sister Carrie*, a dystopian vision of moral economies has been a fixture of American literature. The 2017 video adaptation of Margaret Atwood's novel *The*

Handmaid's Tale depicts the reestablishment of a strict moral economy in the United States, where fertility rates have drastically fallen. The small minority of women who remain fertile are held in reproductive slavery and ritualistically raped by ruling-class men who are perverted and degraded by this arrangement and the strictures intended to prevent them from abusing their power. Diversity of opinion and lifestyle is ruthlessly suppressed as the enslaved women and their male counterparts are forced to constantly monitor one another.

These cautionary tales have not quashed the ideal of moral economies for the far Right, and even for certain nostalgic leftists. But since the era of mass production started in the nineteenth century, only a handful of idiosyncratic and religiously based communities, such as the Amish, have managed to sustain moral economies, which operate mostly outside of the market.

The major alternative idea, and the force behind the politics of the far Left, is central planning, as we discuss in the next chapter. Marxists believed that state ownership of capital and control of industry were the only paths out of “wage slavery,”²⁵ but central planning ultimately proved a failure. The Soviet Union did manage to turn out weapons and build factories but produced drab apartments, dull cars, and shortages of even basic goods. Its central planners could not account for diversity and tastes of individual consumers. All told, the market faces no serious contender as an approach to organizing large-scale economies.

The Rules of a True Market

If the market economy is left with no rivals, we still must ask how markets should be organized. The standard view on the Right is that the government needs only to “get out of the way.” There is a kernel of truth in this argument. When communist

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countries fell in 1989 and the early 1990s, it initially seemed that the removal of the heavy boot of centralized planning was all that it took to yield a flourishing market. Yet any sophisticated, large-scale market depends on well-designed and well-enforced rules of the game without which rampant theft, constant breaking of contracts, and the rule of the physically strongest would prevail. These rules can be boiled down to three principles: freedom, competition, and openness.

In a *free* market, individuals may purchase any goods they want as long as they pay a price sufficient to compensate sellers for the loss of those goods. They also must receive from others for work they do or products they offer just the value that these services create for other citizens. Such a market gives every individual the maximum freedom consistent with not infringing on the freedom of others. As the prominent Philosophical Radical John Stuart Mill put it, “The only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others.”²⁶ Unfree markets deprive individuals of opportunities for gain through trade. A vivid example of restrictions on the freedom of trade is the rationing system imposed in many countries during World War II. While arguably a necessary expedient and social glue in such times, rationing resulted in bland uniformity and gave rise to black and gray barter economies that allowed individuals to trade away, for example, cigarettes they did not smoke for baby food that their children needed. The celebrations in Trafalgar Square and burning of ration books that greeted the UK’s final abandonment of rationing in the 1950s testify to how much people value the flexibility and diversity allowed by free market exchange.

In a *competitive* market, individuals must take as a given the prices they pay and get paid. They have no ability to manipu-

late prices by exercising what economists call “market power.” *Uncompetitive markets* turn self-interest from a productive engine into a destructive scourge by allowing individuals or groups to obstruct trade and reduce production to shift prices in their favor. The struggle against monopolies has been with us at least since the American colonists’ fight against the East India Company’s monopoly on the tea trade. In the late nineteenth century, a popular antimonopolist movement fought against the great cartels of the era, roiling politics and spawning parties such as the Bull Moose party in the United States, the “new Liberal” party in the United Kingdom, the Radical party in France, and the Radical Liberal party in Denmark. Monopolists deliver low-quality goods at high prices. For instance, in most places in the United States there is only one cable service available, but many types of electronic devices to connect to cable. We thus pay high prices for low-quality Internet service, while we can choose from a plethora of high-quality, reasonably priced devices, from computers to phones.

In an *open* market, all people, regardless of nationality, gender identity, color, or creed, are allowed to participate in the process of market exchange, maximizing the opportunity for mutual benefits. Markets that are closed reduce the opportunity for exchange and unfairly cut some people off from the benefits of these exchanges. Opening markets to trade across nations brought pasta to Italy. Opening labor markets to new participants brought the contributions of women into the boardroom. Opening markets for apps brought us the cornucopia of ways in which we now use our smartphones. Open markets embody the idea that by cooperating as broadly as possible, we can all benefit from one another.

Smith saw the markets blossoming around him as not only a productive force, but also a profoundly egalitarian one. He

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famously argued that in a well-functioning market, “The rich . . . are led by an invisible hand to make nearly the same distribution of the necessaries of life, which would have been made, *had the earth been divided into equal portions among all its inhabitants*; and thus, without intending it, without knowing it, advance the interest of the society.”²⁷ The portion of this quotation we have italicized is usually neglected in discussions of Smith, perhaps because it originates from a book that preceded his most famous *Wealth of Nations*. Yet Smith passionately believed that inequality was mainly the result of legal and social restrictions that favored the aristocracy and were incompatible with a market economy.

Smith did not think that free, competitive, and open markets were automatic or inevitable. He observed that “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” and declared that “law . . . ought to do nothing to facilitate such assemblies, much less make them necessary.”²⁸

The central theme of the Philosophical Radicals was the struggle against a society dominated by the aristocracy. The Radicals complained that the aristocracy controlled the government, causing it to protect the aristocracy’s monopolies by restricting markets and closing borders to trade. They understood that economic privilege and political privilege were two sides of the same coin and thus fought with equal vigor for competitive democratic elections through the expansion of the franchise and for open borders to international trade.

These pioneers won many victories, but they soon came to realize their initial proposals did not go far enough. At the same time as markets for land and labor advanced, industrial capitalism showed a tendency toward new forms of monopoly

power over factories, railroads, and natural resources. Expanding the franchise weakened the landed aristocracy, but newly empowered majorities tyrannized minorities of all sorts and capitalists used their resources to corrupt politicians and control the press. The expansion of free trade across borders went hand in hand with international power politics. The leading free trader—Great Britain—exploited its colonies for slave labor and natural resources.

The next generation of liberal reformers in the late nineteenth and early twentieth centuries, individuals such as Henry George, Léon Walras, and Beatrice Webb, sought to address these problems. The effects of their handiwork, which built on the legacy of the Philosophical Radicals, remain with us today. Antitrust policies and legal support for labor unions restrained the power of monopolies. Social insurance, progressive taxation, and free compulsory education enhanced competition by expanding access to opportunity. Systems of checks and balances, protection of fundamental rights, and increasing judicial power to protect minority rights addressed the tyranny of the majority. International institutions, free trade, and human rights treaties were designed to pave the way to greater international cooperation in a liberal order.

Following World War II, these reforms helped usher in an unprecedented period of economic growth, declining inequality, and political consensus in wealthy countries. This great success for liberalism transformed practical politics and academic economics in similar ways. In both spheres, leaders decided that more or less perfect markets had been achieved. Ideas for further breakthroughs in expanding trade or eliminating monopoly power were largely abandoned. Economists came to believe that differences in individuals' natural talents are the main source of inequality. They agreed that progressive

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taxation and welfare systems are needed to ensure a fair distribution, but that they must be limited lest they come at a cost to the size of the total economic pie.

This tradeoff fragmented the liberal coalition. Those who had led the second generation of reforms coalesced into the modern political Left, known as liberals in the United States and social democrats in Europe. They prioritized equality within nations and opening of markets to domestic minorities and women, groups previously excluded from market exchange. During the 1960s and 1970s they won victories in the US Civil Rights movement and the feminist movement throughout the developed world.

Those liberals who prioritized free markets and efficiency over equality formed the modern political “Right” and came to be known as libertarians in the United States and neoliberals in Europe. Beyond fighting government intervention, the Right also played a crucial role in pushing for more open markets for goods and capital internationally. Their great victories came during the 1980s and 1990s, as countries sold off nationalized industries, deregulated the economy, and opened to foreign trade. Yet, while inequality across countries, and between dominant identity groups (white men) and other groups (women, African Americans), declined, inequality within wealthy countries expanded. Growth rates declined and never returned to their midcentury levels. With economic stagnation and rising inequality within countries—stagnequality—politics have become fractured and poisoned.

While some commentators believe that stagnequality is the result of broad economic and demographic forces that are beyond people’s control, we believe that it is the result of a failure of ideas. The economic wisdom of left and right did not cut to the core of the tensions in the basic structure of capitalism and

democracy. Private property inherently conferred market power, a problem that ballooned along with inequality and that constantly mutated in ways that frustrated efforts by governments to solve it. One-person-one-vote gave majorities the power to tyrannize minorities. Checks, balances, and judicial intervention limited such tyranny, but did so by handing power to elites and special interest groups. In international relations, efforts to enhance cooperation and cross-border economic activity empowered an international capitalist elite that disproportionately benefited from international cooperation and faced nationalist backlash from the working class.

The ideological and military victories of World War II and the Cold War, accompanied by economic and political achievements of the second half of the twentieth century, thus bred arrogance, which led to complacency and internal division. The radical reformers of the nineteenth and early twentieth centuries became the squabbling technocrats of today.

Perfect Competition: Opium of the Elites

The intellectual basis of this bind was economists' increasing assumption that markets are "perfectly competitive,"²⁹ meaning that there are a small number of homogeneous commodities, and no individual holds or buys a large fraction of any of them. All are forced to vigorously compete to sell their products and to purchase the things they need from others. Grain is the classic example of a perfectly competitive market. No producer of grain owns a large share of the market and thus no one producer can affect the price much. In addition, because so many millers, ranchers, and bakers buy grain, no one buyer can hold down its price by withholding purchases. All must accept whatever price the market offers them.

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Yet few markets in the real world work this way, as pioneering economic theorists like Joan Robinson realized.³⁰ Consider the process of buying a home. The housing markets that come closest to being perfectly competitive are those in large cities where houses frequently become available and many people are looking to buy. Yet as anyone who has bought or sold a house in such a place knows, the system is far from perfect. Houses differ in location, amenities, views, light, and so forth. They are far from homogenous, nothing like grain (whose homogeneity is itself the result of careful market design).³¹ The failure to reach a deal can mean months of delay while buyers look for other houses that might meet their needs.

This means that buyers and sellers both have significant bargaining power. Each party works hard to ascertain what the other would be willing to pay or accept and jockeys for the best price possible. Such strategic behavior often causes trades to fail. Even when they succeed, huge amounts of time and effort have been wasted in the process. These problems are magnified in complex business transactions. For example, in land development schemes, where many contiguous pieces of land must be bought up to build a factory or a mall, the existing homeowners have the upper hand in bargaining because the stakes are so high for the developer. Many homeowners will hold out for a large payment, delaying or even stopping the project.

Most markets in which individuals and businesses participate are more like the housing market than the grain market. Factories, intellectual property, companies, paintings—all are highly idiosyncratic, one-of-a-kind assets. In these and many other cases, the assumption of perfect competition makes little sense. The same holds true for labor markets, since all workers have different talents and dispositions and live in different places. Even in many markets for relatively homogenous com-

modities, such as Internet services or airplane flights, a few dominant firms prevail. And even when there appear to be many such firms, they frequently share owners or they collude. From bottom to top, market power—the ability of companies and individuals to affect prices in their favor—permeates the economy. We claim that market power is omnipresent and intrinsic to the current institutional structure of capitalism and that it is one of the two dominant sources of stagnation and political conflict.

The other primary problem, we believe, is that, at the same time that some markets are clogged with market power, many areas of human life are lacking in markets that could vastly improve people's well-being. This problem is most acute for goods and services usually provided by governments, like policing, public parks, roads, social insurance, and national defense: what is needed is a market for political influence.

A market for political influence? That sounds preposterous. If money were allowed to purchase political influence, wouldn't politics be controlled by a few plutocrats? The history of political corruption in the late nineteenth-century United States bears this out. Local politicians were commonly bought off by political machines, railroad men, and oil barons.

Yet the alternative model, that every citizen should have an equal voice and thus that every issue is determined by majority rule, has its own severe weaknesses. Once the majority rules, what happens to those in the minority? They may care deeply about an issue—say the right of transgender people to use a restroom, or preventing abortions—but there is no way for them to exert influence in proportion to the importance of that issue for them. One-person-one-vote stops compromise among groups of people and leads to wild swings of power between ideological blocs.

Politics is not the only realm of contemporary life in which markets are almost entirely absent. Severe restrictions on migration halt cross-border trade in labor, creating a hole in the labor market. Data, one of the most valuable commodities in the digital economy, are collected and monetized by companies such as Google and Facebook, but the users who create these data receive no direct compensation. A much-needed market in data simply does not exist. Our supposedly perfectly competitive market economy, so it would seem, is actually plagued by monopolized and missing markets.

These observations cast doubt on the rosy assumptions of standard economic rhetoric, yet they also reveal missed opportunities. If we face the fact that markets are hampered by market power and often are even absent, then perhaps we can escape polarization between left and right, and renew the Radicals' fight against prejudice and privilege.

Imagining Radical Markets

Our solution to the present crisis is to radically expand markets. Chapters 1 and 2, which present the central ideas in this book, describe how this can be done in the economy and in politics. Chapter 1 shows how a simple tax can greatly reduce the incentive to abuse market power and limit competition by converting the market in private property into a kind of market in “uses.” Chapter 2 describes an efficient market for “public goods” shared by many people and normally created by governments. The other chapters have narrower foci: chapter 3 advocates policies to create a more efficient and politically sustainable market in migrant labor; chapter 4 argues for a limit on financial holdings that would break the stranglehold of institutional investors on the corporate economy;

chapter 5 demonstrates how market forces can be extended to the digital economy. The ideas in these chapters have the power to solve the crisis of our time. They can advance equality and economic growth, while promoting public order and the spirit of compromise.

Any agenda that aspires to such sweeping changes faces enormous barriers to its adoption. Our proposals will require years of testing, improvement, and gradual scaling up before they are ready for full implementation.

To help readers grasp how radical these ideas are, we begin each chapter with a fictional vignette that illustrates how they might work in a future society. We then examine the history behind the institutions we propose to uproot, highlighting the accidents, paradoxes, and missteps that have led us to the present crisis. Next come our proposals, laid out in simple terms, followed by a defense of them in which we address common objections. Finally, we offer some ways that our ideas could be tested and refined.

Each chapter can stand on its own, but the conclusion ties the proposals together and discusses how much they would achieve if implemented together. An epilogue imagines what will take place when the gains from radical markets are exhausted.

Even if we don't sell you on all our ideas, we hope this book will open your mind to a new way of imagining the economy and politics. This challenging moment, when long-held assumptions are being overturned, is ripe for radical rethinking.

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