

# Winner-Take-All Politics: Public Policy, Political Organization, and the Precipitous Rise of Top Incomes in the United States\*

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## Abstract

The dramatic rise in inequality in the United States over the past generation has occasioned considerable attention from economists, but strikingly little from students of American politics. This has started to change: in recent years, a small but growing body of political science research on rising inequality has challenged standard economic accounts that emphasize apolitical processes of economic change. For all the sophistication of this new scholarship, however, it too fails to provide a compelling account of the political sources and effects of rising inequality. In particular, these studies share with dominant economic accounts three weaknesses: (1) they downplay the distinctive feature of American inequality—namely, the extreme concentration of income gains at the top of the economic ladder; (2) they miss the profound role of government policy in creating this “winner-take-all” pattern; and (3) they give little attention or weight to the dramatic long-term transformation of the organizational landscape of American politics that lies behind these changes in policy. These weaknesses are interrelated, stemming ultimately from a conception of politics that emphasizes the sway (or lack thereof) of the “median voter” in electoral politics, rather than the influence of organized interests in the process of policy making. A perspective centered on organizational and policy change—one that identifies the major policy shifts that have bolstered the economic standing of those

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at the top and then links those shifts to concrete organizational efforts by resourceful private interests—fares much better at explaining why the American political economy has become distinctively winner-take-all.

### Keywords

inequality, American politics, business, power, public policy, political organization

Amid the greatest economic crisis since the Great Depression, the growing gap between the middle class and the rich has moved from the periphery to the center of political debate. Revelations about the Wall Street excesses that fueled the present crisis—excesses often promoted by public officials—have led many to conclude that those at the top have benefited from a rigged system that has allowed privileged insiders to make fortunes while shifting the negative effects of their activities onto the broader public.<sup>1</sup> Although the current crisis has given the issue new urgency, the distributional tilt that it highlights is hardly new. Fueled by the outsized gains of the affluent, inequality has been increasing for more than a quarter century, fundamentally reshaping the distribution of income in the United States.

The dramatic rise in inequality has prompted a huge outpouring of commentary and analysis. Until recently, however, most of this discussion has focused on the hypothesized *economic* roots of rising inequality: increasing global integration, rising returns to education, changing technology, heightened domestic competition, and so on. The relationship between American *politics* and the sharp rise in inequality, by contrast, has been notable for its absence.

This has started to change. The past few years have seen a small but prominent wave of books and articles on rising inequality by students of American politics.<sup>2</sup> These valuable works suggest that politics and public policy have played a more central role in the rise in inequality than economic accounts suggest, and they have begun to investigate the previously neglected links between growing inequality and the actions of public officials.

Yet these works, too, are incomplete. They rightly depart from standard economic accounts that focus on depoliticized processes of economic change. Yet they have not produced a convincing political analysis of the political roots of rising inequality that can rival the dominant economic perspective on the issue that casts inequality as a political—in large part because they approach the politics of U.S. inequality with a relatively narrow analytic frame that embodies a number of constraining features of contemporary American politics research.

By a “convincing political analysis,” we mean an analysis that meets two tests. First, it must be consistent with the known facts about inequality. In particular, we argue that it must be consistent with the fact that American inequality is “winner-take-all,” with a very small slice of the population becoming dramatically richer and the rest largely holding steady. Second, a convincing analysis must show how political processes and government policy are causally related to the known facts about economic inequality. In other words, it must identify the correct set of outcomes and explicate their relationship to American politics and public policy.

Economic accounts generally falter on both these tests. Most have downplayed the highly concentrated nature of economic gains, emphasizing instead the general widening of the gap between those with advanced degrees and skills and those without them. And even those economic accounts that have recognized the top-heavy quality of American inequality have had surprisingly little to say about the role of government policy in fostering it. This would be unproblematic, of course, if public policy had really played as limited a role as many of these economic accounts imply. But, as we will show, there is very strong evidence for a central role for public policy, particularly with regard to the run-up of incomes at the very top.

The new wave of political accounts fares much better, but still falls short on both tests. For the most part, these accounts neither accurately describe the distributional changes that have occurred nor offer plausible accounts of the political and policy processes behind those changes. Yet the shortcomings of existing political accounts stem from a different source than the shortcomings of existing economic accounts. Economic accounts tend to ignore American politics entirely, to their considerable detriment. Recent political science studies instead miss the mark because of a commitment to a particular vision of American politics that we call “politics as electoral spectacle.” In this perspective, the driving force behind policy changes is the ability of the so-called median voter—the swing voters in the middle of the distribution of opinion and income among voters—to discipline politicians through the “electoral connection.”<sup>3</sup> As we demonstrate, however, the sharp upward skew of income since the 1970s is exceedingly hard to explain with models that revolve around the strength or limits of median-voter influence. Instead, it calls for an alternative perspective—which we call “politics as organized combat”—that emphasizes the role of organized interests in shaping large-scale public policies that mediate distributional outcomes.

We make this argument in five steps. First, we present the evidence that American economic inequality has been winner-take-all, with the gains at the top highly concentrated, sustained for a generation, and accompanied by few trickle-down benefits for the rest of the population. Next, we show that existing economic accounts are largely inconsistent with this pattern, and that existing political accounts, while stronger in identifying the political roots of rising inequality, neglect some of the most important policy foundations of winner-take-all inequality and some of the most fundamental political mechanisms that have brought it about.

We trace this failure to a view of American politics that overemphasizes the voter–politician nexus while neglecting the role of organized interests and the profound effects of government on the distribution of market rewards. In place of this conventional view, we develop an alternative organizationally minded and policy-focused perspective. This alternative becomes the lens through which we examine how major organizational shifts in the 1970s tilted the balance of political power sharply in favor of those at the very top of the economic ladder, paving the way for America’s winner-take-all inequality. Finally, we bring these analytic elements together to show that winner-take-all inequality is substantially rooted in fundamental shifts in four core areas of U.S. public policy—related to financial markets, corporate governance, industrial relations, and taxation—that have been powerfully driven by this political-organizational transformation.

## The Rise of Winner-Take-All Inequality

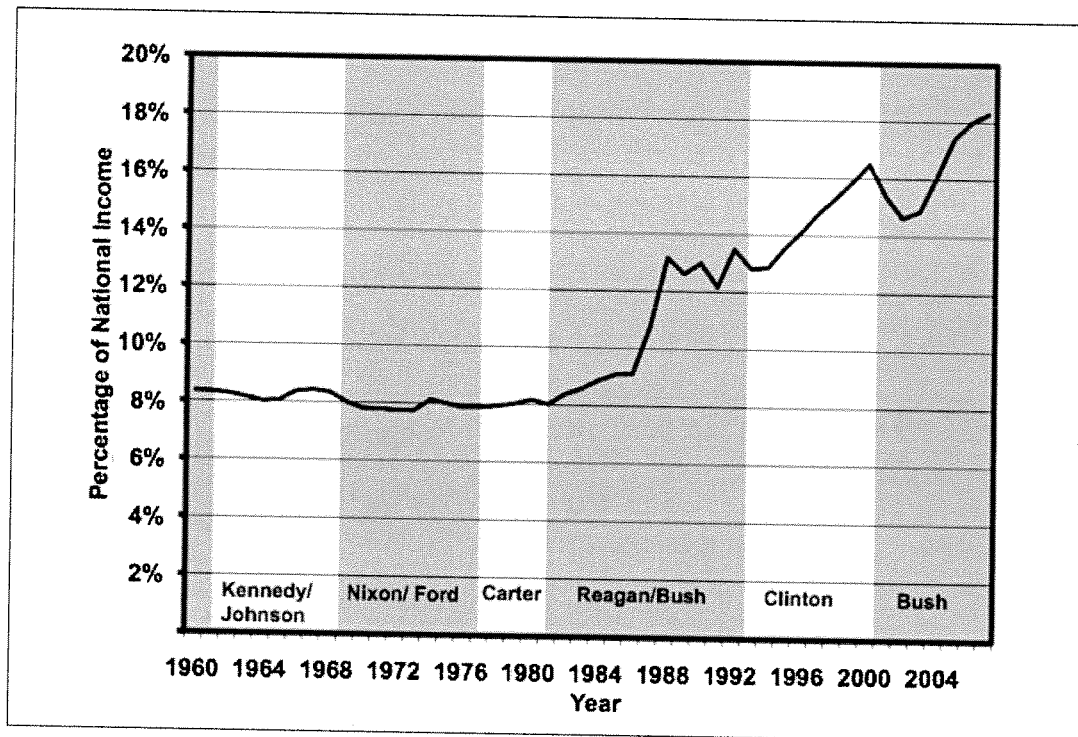
That income inequality has grown substantially over the past thirty years is no longer in dispute. Yet persistent confusion remains about the exact nature of this change and its main causes. Indeed, these two sources of confusion are linked, since properly identifying the character of American inequality is essential to offering convincing explanations of its rise.

As we show in this section, the three crucial features of growing U.S. inequality are that (1) economic gains have been highly concentrated at the very top; (2) these lopsided gains have been sustained, growing virtually without interruption since around 1980; and (3) these gains have resulted in few “trickle-down” benefits for most of the population. Together, these three features call into question standard economic accounts of rising inequality that focus on gaps between broad groups based on rising returns to education and skills. They also call into question the leading political science accounts of rising inequality taken up in the next section, which also tend to focus on the growing distance between the top and bottom thirds of the population rather than the pulling away of the very affluent.

### *1. Gains Have Been Highly Concentrated*

Many observers have mistakenly characterized rising inequality as simply a general stretching of the distribution, with the rungs on the economic ladder remaining more or less evenly spaced as they move apart. This portrayal is often grounded in general survey data on incomes (such as the Census Bureau’s March Current Population Survey). Survey data, however, are notoriously poor at capturing trends at the top of income ladder. A much more accurate and revealing picture is provided by studies based on tax statistics, such as the well-known series on U.S. inequality compiled by Thomas Piketty and Emmanuel Saez.<sup>4</sup> These data—based on incomes actually reported by tax filers—allow us to look with considerable accuracy at the very top of the distribution.

What these statistics show is that while gaps have grown across the income spectrum, the real action is at the top, especially the very top.<sup>5</sup> The share of pretax income earned by the richest 1 percent of the U.S. population, for example, has increased from around 8 percent in 1974 to more than 18 percent in 2007. Including capital gains like investment and dividend income, the share has gone from just over 9 percent to 23.5 percent. Moreover, the top 1 percent are not the most fortunate beneficiaries of the post-1980 income explosion at the top. The more exclusive the group, the more stratospheric the gains have been. The top 0.1 percent (the richest 150,000 or so families) have seen their slice of the pie grow from 2.7 percent to 12.3 percent of income—a more than *fourfold* increase. Meanwhile, the top 0.01 percent (the richest 15,000 or so families) have seen their share of income rise from less than one in every one hundred dollars in 1974 to more than one of every seventeen—or more than 6 percent of national income accruing to 0.01 percent of families. This is the highest share of income going to this rarified group ever.



**Figure 1.** The richest 1 percent's share of national pretax income, 1960–2007

Sources: Thomas Piketty and Emmanuel Saez, "Income Inequality in the United States, 1913–1998," *Quarterly Journal of Economics* 118, no. 1 (2003): 1–39; and Thomas Piketty and Emmanuel Saez, updated tables and figures for Piketty and Saez 2003, <http://elsa.berkeley.edu/~saez/TabFig2007.xls> (accessed December 2009). Note: Excluding capital gains.

## 2. Gains Have Been Sustained

The income tax data also reveal that the shift of income toward the top has been *sustained*, increasing steadily (and, by historical standards, rapidly) since around 1980. Figure 1 shows the share of national income that goes to the top 1 percent of households. The only reversals apparent in the post-1980 upward trend occur during the dives in the stock market that occurred in the late 1980s and around 2000. (This is even more apparent when capital gains are included in income, but since capital gains fluctuate from year to year, excluding them makes sense when examining over-time trends.) In short, the growing share of national income captured by the richest of Americans is a long-term trend that does not appear to be obviously related to either the business cycle or the shifting partisan occupation of the White House.

## 3. Gains Have Resulted in Few Trickle-Down Benefits for the Nonrich

Finally, these massive gains at the top were not accompanied by major gains on lower rungs of the income ladder. This is a more controversial point than the first two, since it concerns both relative gains (which unquestionably favor those at the top) and trends in

the absolute standing of the nonrich (which is the subject of greater dispute). To accurately assess these broader effects of rising inequality requires including government taxes and benefits in our measure of family income, since government benefits can be a substantial source of income for middle- and low-income Americans. The Congressional Budget Office (CBO) has developed these broader indicators.<sup>6</sup> Although available only back to 1979—unlike the Piketty and Saez pretax income series, which goes back to the early twentieth century—this augmented income dataset is widely considered the gold standard for studying family income trends, providing as accurate a picture as we can currently get of trends in household income at various points in the distribution.

This picture turns out to be stark: The bottom of the distribution went nowhere, the middle saw a modest gain, and the top ran away with the grand prize. While the overall economy expanded substantially between 1979 and 2005, the average incomes of the poorest fifth of households increased by only around 6 percent and the middle quintile of households saw their incomes rise just 21 percent, even when inflation and government taxes and benefits are taken into account. Meanwhile, the average after-tax incomes of the richest 1 percent of households rose nearly 230 percent. And, again, the gains enjoyed by the top 1 percent pale in comparison to those received by the top hundredth of 1 percent. Between 1979 and 2005, the CBO numbers show, the average after-tax income of households in the top 0.01 percent increased from just over \$4 million to nearly \$24.3 million—an almost sextupling in a little more than a quarter century.

Based on the CBO data, Table 1 shows how little trickle-down seems to have occurred. It compares how much each income group actually received with what their incomes *would have been* if incomes had grown at equal rates across the class spectrum between 1979 and 2005. In other words, what if overall growth had been the same, but the share of income received by each income group had remained constant? The first column shows the average effect on household income for households in each group. The second column shows the *total* income change for that the group, which is simply the average income times the number of households in the group.

The first column drives home that few of the benefits of economic growth at the top between 1979 and 2005 trickled down. Note that the bolded figures apply only to the top 10 percent of households. These are the households that did better than average. Turned around, *every income group below the top 10 percent saw their incomes rise more slowly than average household income between 1979 and 2005*. The average income of the middle fifth of households would be \$10,000 higher in 2005 if they had experienced the average growth of household income, rather than their actual income growth, over this period.

In the aggregate, as the second column shows, the income gap between the two scenarios (average vs. actual) is largest for the middle fifth of households—a group that we will see is at the center of the “median-voter” models popular in political science. But as the table demonstrates, the gains of equal growth would have been broadly distributed among the bottom 80 percent of Americans, which would have collectively gained by more than \$700 billion. Remember, this would be the size of the transfer *each and every year*. No less striking, that \$700 billion is only slightly more than what the top 1 percent gives up under the equal-growth scenario (\$673 billion).

**Table 1.** Inequality by the Numbers

How much more (or less) would each income group have received in 2005 if post-tax-and-transfer household income had grown at the same rate for all groups from 1979 to 2005?

Income group	Difference in average <i>per household</i> (\$)	Total income difference <i>for group</i> (\$)
Bottom fifth	5,623 richer per household	136 billion richer as a group
Second fifth	8,582 richer	189 billion richer
Middle fifth	10,100 richer	224 billion richer
Third fifth	8,598 richer	194 billion richer
Next tenth	3,733 richer	43 billion richer
Next 5 percent	<b>4,912 poorer</b>	<b>29 billion poorer</b>
Next 4 percent	<b>29,895 poorer</b>	<b>140 billion poorer</b>
Top 1 percent	<b>597,241 poorer</b>	<b>673 billion poorer</b>

Source: Authors' calculations based on Congressional Budget Office (CBO), *Historical Effective Federal Tax Rates* (Washington, DC: CBO, December 2007).

Note: Negative numbers in bold.

Essentially, then, the losses of the more than ninety million households in the bottom 80 percent that are implied by the move from average to actual experience equal the gains of the slightly more than one million households in the top 1 percent.

Another way to see the same set of trends is to examine how well families in the fourth quintile (the sixtieth to the eightieth percentile) did relative to two contrasting groups: those in the bottom quintile and those in the top 10 percent. Was the post-1979 economic trajectory of the solidly middle-class sixty–eighty group closer to the average experience of those lowest on the economic ladder or those highest on it? After all, even if middle-class Americans would have been better off had they experienced the average growth of household income over this period, they might still see their fate as intertwined with the fate of the affluent if those at the bottom slipped away from the top much more rapidly than they did.

This is not, however, what happened. The bottom fifth (zero–twenty) did experience slower income growth than the fourth quintile (sixty–eighty), but the gap in growth between these two groups is dwarfed by the gap in growth between the fourth quintile and the top 10 percent. Among the bottom fifth, real income increased by a vanishingly small 6.25 percent between 1979 and 2005, compared with a more robust but still modest 29.47 percent among the sixty–eighty group. But real income more than doubled (103.22 percent) among the top 10 percent (and, as already noted, it more than tripled among the top 1 percent). To return to the thought experiment in Table 1, it would have required an aggregate transfer of \$80 billion from the sixty–eighty segment of the distribution to the bottom fifth in 2005 to equalize the post-1979 growth in income between the two groups. The aggregate transfer from the top 10 percent that would have been required to equalize income growth between the sixty–eighty group and the top 10 percent would be more than \$1 *trillion*. If income growth is the only criterion, the middle-class sixty–eighty group has far more in common with the poor than the rich.

A critic of this interpretation might question the implicit portrayal of the economy as a zero-sum game and argue that the gains of the rich did not come at the expense of other income groups, because the economy would have grown more slowly if the gains of growth had been more broadly distributed. An important test of this argument is whether growth rates were higher in the United States than in Europe, where inequality did not rise as sharply. The answer is no. On average, between 1979 and 2005, the American economic engine ran just about as hot as the European economic engine.<sup>7</sup> What is more, Americans households increased their work hours substantially over this period. In fact, this increase turns out to account for about two-thirds of the household income gains among the middle fifth.<sup>8</sup> By contrast, the rise in work hours (the product of average hours worked per active worker and the rate of labor-force participation) was much more modest in Europe. As a result, *GDP per hour worked actually rose faster in Europe than in the United States between 1979 and 2005.*<sup>9</sup> This lends credence to the view that the gains of the well off came at least partially at the expense of those lower on the income ladder. So, of course, do the huge costs for middle-class families associated with the current economic crisis, which itself is closely related to many of the trends discussed in this article.

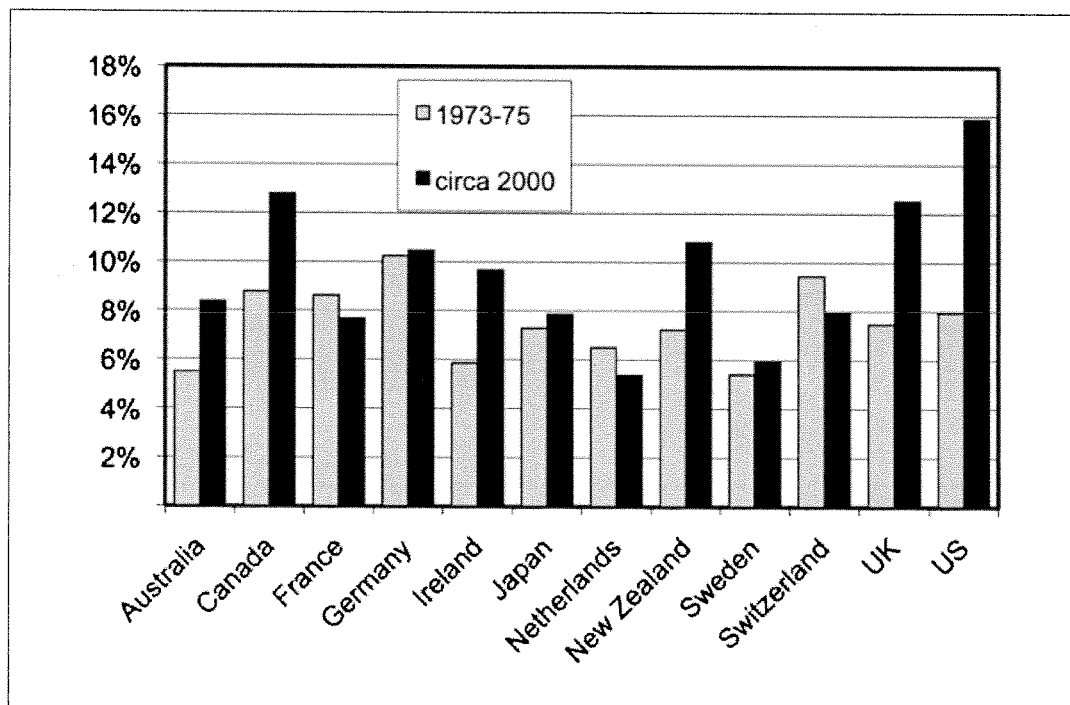
## **Why Winner-Take-All? The Weaknesses of Existing Accounts**

The three salient trends discussed in the last section—that income has become hyperconcentrated at the top, that the increase in income hyperconcentration has been sustained, and that this hyperconcentration has produced few, “trickle-down” benefits for the vast majority of American households—raise difficult problems for standard economic analyses of rising inequality that emphasize autonomous market changes that have widened the gap among broad skill and educational groups. They also, however, call into question some central features of recent works that move beyond this economic emphasis to bring in politics.

### ***Economic Accounts***

By far the dominant economic explanation for rising inequality emphasizes “skill-biased technological change”—a shift toward greater emphasis on specialized skills, knowledge, and education—that has fueled a growing divide between the highly educated and the rest of American workers.<sup>10</sup> The evidence just reviewed on the changing income distribution shows, however, that American inequality is not mainly about the gap between the well educated and the rest, or indeed about educational gaps in general. It is about the extraordinarily rapid pulling away of the very top. Those at the top are often highly educated, but so too are those just below them who have been left behind. Put another way, the distribution of educational gains over the last twenty-five years—who finishes college or gains advanced degrees—has been much broader than the distribution of economic gains. Only a very small slice of the new educational elite has entered the new economic elite.





**Figure 2.** The top 1 percent's share of national income, mid-1970s versus circa 2000

Source: Andrew Leigh, "How Closely Do Top Incomes Track Other Measures of Inequality?" *Economic Journal* 117, no. 524 (2007): 619–33, <http://econrsss.anu.edu.au/~aleigh/pdf/TopIncomesPanel.xls>.

Another problem for the standard economic account is that the United States looks distinct from other nations, despite the fact that all these nations have presumably been buffeted by similar market and technological forces. American inequality is the highest in the advanced industrial world. Yet gaps in skills are not measurably larger in the United States than they are in other affluent nations. And while the return to schooling is higher in the United States, this explains only a trivial portion of American inequality relative to inequality in other nations.<sup>11</sup>

American distinctiveness is particularly pronounced when it comes to the hyperconcentration of income at the top. Figure 2 shows the share of income, excluding capital gains, going to the top 1 percent in twelve rich nations. The first bar shows the share in the mid-1970s (1973–75); the second shows the share around the millennium (1998–2004). As the figure makes clear, the United States leads the pack with regard to both the level (16 percent) and increase (virtually a doubling) of the top 1 percent's share of income. Note that half of the nations in Figure 2—France, Germany, Japan, the Netherlands, Sweden, and Switzerland—experienced little or no increase. Note, too, that the United States was similar to many of these nations in terms of the share of income going to the top 1 percent in the 1970s—indeed, the shares in the United States and Sweden track very closely until around 1980.

It is true that the other English-speaking nations in this group—Australia, Canada, Ireland, New Zealand, and the United Kingdom—have followed a path more like the United States's, suggesting overlapping policy and political trends. Still, the United

States stands out even among these nations, experiencing a doubling of the income share of the top 1 percent between the mid-1970s and 2000, compared with around half that in percentage terms in the other five nations. (The difference is smaller if 1980 is used as the base year, rather than the mid-1970s, but the United States still experienced a larger percentage increase—despite starting from a higher base.)

Moreover, the trajectory of the two countries that are most often compared to the United States's, the United Kingdom and Canada, cannot be viewed as wholly independent of the rise of America's winner-take-all economy. As we will see, the rise in the compensation of the highest earners, especially corporate executives and financial managers, drives much of the outsized gains at the top in the United States. Companies in English-speaking Canada and the United Kingdom compete for these workers, and thus have faced the most pressure to match the massive salaries on offer in the United States. There is substantial evidence that much of the (considerably smaller) rise in executive compensation in Canada is driven by American developments, rather than reflecting an independent example of the same phenomenon.<sup>12</sup> The same argument may apply to Britain as well, although this is harder to establish. While the contagion effect of the United States is difficult to quantify, some (and perhaps much) of the increase in top incomes in other English-speaking nations may reflect competitive pressure to match the more dramatic rise in the United States—a rise that we shall see has a great deal to do with U.S. public policy.

Some economists have accepted that American inequality has been distinctly top-heavy, but insist that the market still rules. The economist (and former Bush administration official) Gregory Mankiw has evocatively likened the American super-rich to the winners of the golden ticket in *Charlie and the Chocolate Factory*.<sup>13</sup> Most of the educated receive only the chocolate bar; a lucky few find a ticket to vast riches within the bar's wrapper. But Mankiw's analogy is silent on the question of *how the tickets were placed in the chocolate bar and why some of the educated get the ticket and others do not*. It implies that both the presence of the tickets and the selection is market-driven, when in fact, as we shall see, Mankiw's "golden tickets" were in substantial part created by government, and their distribution has been deeply shaped by the political clout of their beneficiaries.

To be sure, market processes and technological changes have played a significant part in shaping the distribution of rewards at the top. Revolutionary changes in information technology have fostered more concentrated rewards in fields of endeavor—such as sports or entertainment—where the ability to reach large audiences is the principal determinant of economic return.<sup>14</sup> Computers, increased global capital flows, and the development of new financial instruments have made it possible for savvy investors to reap (or lose) huge fortunes almost instantaneously. Other examples of such technologically driven winner-take-all inequality can be found. But these accounts do not come close to explaining the concentrated gains at the very top of the American economic ladder, especially those driven by rising executive pay and financial market compensation. They do not explain why these trends have been much more pronounced in the United States than elsewhere. Nor do they explain why market structures conducive to such outcomes arose when they did, much less why, as we show, those structures were fostered by government.

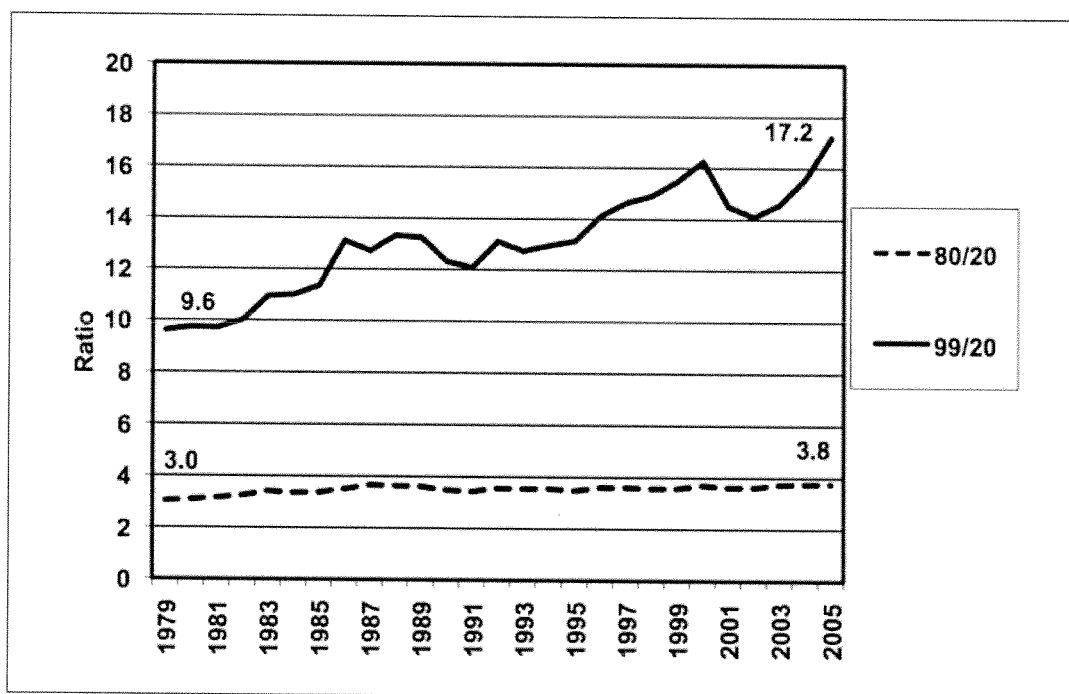
### Political Accounts

This brings us to the small but growing number of *political* explanations of the rise of inequality in the United States.<sup>15</sup> Not surprisingly, these accounts—which have not converged on a preferred explanation to the same degree as has occurred in economics—place greater emphasis on politics. Yet they still suffer from four notable weaknesses: (1) a neglect (shared with economic accounts) of the growing concentration of income at the top; (2) an overemphasis on the “median voter” as the crucial constraint on or source of inequalitarian policy trends; (3) an extremely thin consideration of the policy sources of rising inequality, focusing narrowly on direct tax-and-transfer programs; and, finally, (4) a striking lack of attention to the role of organized interests. These weaknesses, we argue, have a common source—a view of politics dominant in American politics research in which elections and voter preferences are the main focus. We call this view “politics as electoral spectacle” and contrast it with a view that more accurately captures the politics of rising inequality, “politics as organized combat.”

*1. Neglecting winner-take-all inequality.* In common with economic accounts, existing political analyses tend to emphasize the broad spreading out of the income distribution, rather than the hyperconcentration of income at the top. This misplaced focus is, in some ways, even more problematic for political accounts than economic accounts. This is because the top-heavy quality of American inequality poses a stark puzzle for standard models of politics that emphasize the preferences of the median voter. Put simply, it is much easier for these models to account for a modest upward income skew than extreme concentration at the top.

At the same time, most opinion data—the sine qua non of behavioral political science—does not reach enough citizens at the top to form a reliable picture of how their views or political activities differ from those lower on the economic ladder. (In this respect, opinion data share the problem of survey data on incomes—they miss the very top of the distribution.) Thus, both theoretical inclinations and available data push political scientists to treat rising inequality as essentially a growing gap between the bottom third and top third of the income distribution, precisely the conception that we have argued has led commentators and analysts astray.

An example will serve to illustrate the point. In a much-discussed and justly influential book, *Unequal Democracy*, Larry Bartels argues that since World War II, Republican presidents have more or less consistently abetted inequality while Democratic presidents have more or less consistently reduced it. Because Bartels relies on survey data on income that are topcoded, however, he has very little to say about the spectacular rise of high-end incomes. In fact, Bartels’s main measure of inequality is the eighty–twenty ratio, the ratio of income at the eightieth and twentieth percentiles. Yet the eighty–twenty ratio leaves out most of the story of rising inequality. According to the CBO post-tax-and-transfer data, the eighty–twenty ratio rose from just over 3 in 1979 to 3.77 in 2005—an almost 25 percent increase. Over the same period, however, the ratio of the *ninety-ninth* percentile to the twentieth percentile rose from 9.62 to 17.18—an almost 80 percent increase (Figure 3). Obviously, the ninety-nine–twenty ratio is going to be bigger than the eighty–twenty ratio. But there is no mathematical



**Figure 3.** Eighty–twenty and ninety–nine–twenty ratios, post-tax-and-transfer income, 1979–2005

Source: Authors' calculations based on Congressional Budget Office (CBO), *Historical Effective Federal Tax Rates* (Washington, DC: CBO, December 2007).

reason why the *percentage increase* should be so much greater; it is a reflection of the extremely skewed income growth of the past generation.

As it turns out, when Bartels looks at the relationship between the eighty–twenty ratio and the partisan identity of the president, the association he finds is driven by the growth of income at the twentieth percentile under Democratic presidents, not by the positive effects of Republican presidents on growth at the top. (In fact, the ninety–fifth percentile—the highest income group he looks at—seems to do about as well under either party, and in his regressions, Bartels never finds statistically significant partisan differences in income growth above the fortieth percentile.) In other words, Bartels's argument about partisanship boils down to the claim that those on the bottom portions of the income ladder do much worse under Republicans than under Democrats. This is an important insight—leaving open the question of whether it actually reflects the differing policies of Republican and Democratic presidents, as we discuss in a moment—but it does not directly address the issue of why growth has been so skewed toward the very top since the late 1970s.

Once we shift our gaze to the biggest fact about American inequality—the steady upward rise of the share of income going to the top 1 percent shown in Figure 1—a simple partisan story becomes much harder to sustain. Instead, something happened around 1980 that resulted in a fairly consistent upward trend in the fortunes of those at the very top, regardless of the partisan identity of the president.<sup>16</sup> Bartels's analysis has

little to say about this trend, which we have shown is the crucial one for understanding the rise in American inequality. Not only does he focus on the eighty–twenty ratio; his analysis is also, by his own admission, much stronger at explaining the ebb and flow of the eighty–twenty ratio *before* 1980—that is, before most of the stunning rise in inequality. In other words, Bartels’s analysis is pitched at explaining a measure of inequality that systematically understates the growth of inequality at the very top, and his explanation works much better during the period before the big run-up in inequality occurred.

2. *Overemphasizing the median voter.* Voters and their preferences are seen as at the center of existing political accounts of rising inequality. Indeed, it is not too much of an exaggeration to say that the central problem for these accounts is trying to explain how rising inequality is consistent with competitive electoral politics. In a competitive system, after all, rising inequality—especially rising inequality that makes most citizens relatively worse off—should create pressures for a government response, as politicians vie to attract majority support. The lack of such a response is thus deeply puzzling in standard median-voter models of redistribution, which argue that greater inequality in the distribution of market income (typically operationalized as the ratio of median income to mean income) should lead to greater median-voter support for redistribution and, thereby, more redistributive public policy.<sup>17</sup> And, indeed, in virtually every affluent democracy, governments have adjusted taxes and benefits to at least partly mitigate rising inequality in pre-tax-and-transfer incomes.<sup>18</sup>

But not in the United States, where precisely the opposite pattern can be seen. Between 1980 and 2003, according to a recent analysis using the Panel Study of Income Dynamics, the amount by which government taxes and benefits reduced inequality (as measured by the Gini index, a common inequality standard) fell substantially.<sup>19</sup> Inequality in what people earned rose. But instead of offsetting this rise, government taxes and benefits actually exacerbated it. And when we take into account the myriad ways in which government has abetted the rise in market incomes at the top to be discussed later, it is even clearer that government policy has increased, rather than offset, rising inequality.

Political scientists committed to the “politics-as-electoral-spectacle” view have taken one of two tacks to explain runaway inequality: they have endeavored (unsuccessfully) to show that the median-voter model really works; or they have offered amendments to the model that show why voters have not been as effective a check on politicians as the model predicts. The former arguments fail on their face. The latter raise the question of where, if not from voters, pressure for inequality-abetting policies comes from—a question that these accounts, with their focus on the voter–politician nexus, are poorly equipped to answer.

The first response is exemplified by Nolan McCarty, Keith Poole, and Howard Rosenthal’s important book, *Polarized America*. Working within the median-voter model, McCarty, Poole, and Rosenthal argue that pressures for redistribution amid the era of rising inequality have been muted by the influx of low-income immigrants. Immigration has two effects that decrease the median voters’ demand for redistribution. First, it brings a substantial number of nonvoters into the lower part of the income

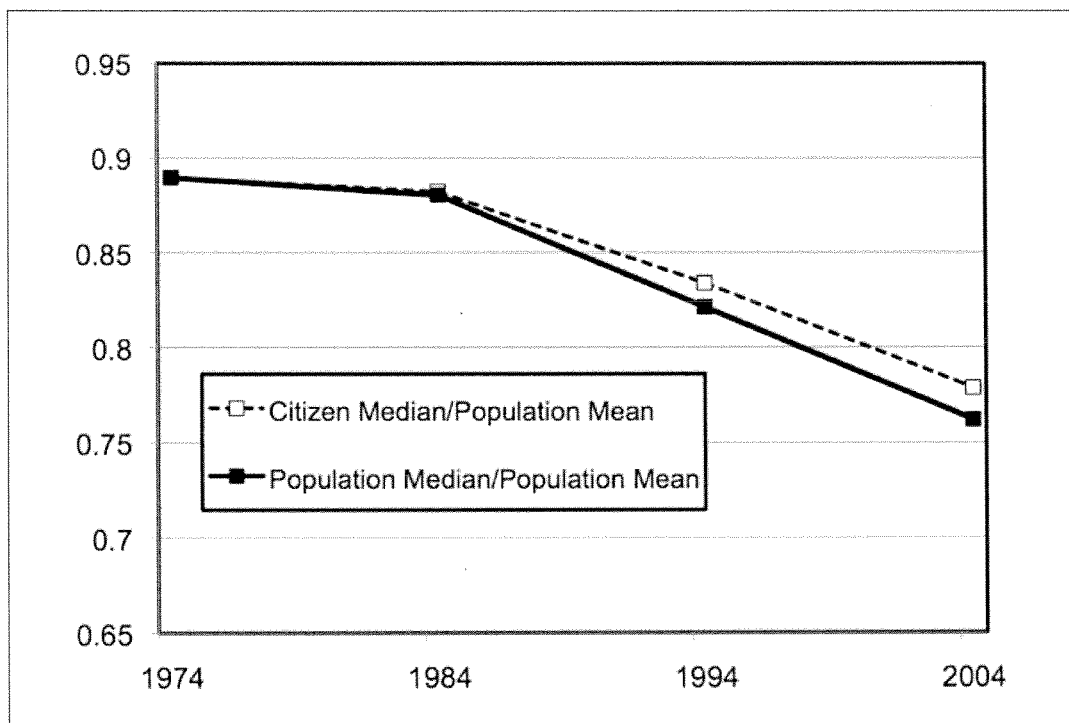
distribution, pushing up the income of the median voter relative to the average income of all U.S. residents. Second, immigration pulls down average income, once again increasing the income of the median voter relative to the average. The net effect, they argue, is that “voters are doing as well as they have ever done.”<sup>20</sup> And because the “relative income of the median voter in the United States is in fact not worse today than it was thirty years ago,” pressure for redistribution on politicians has been muted despite rising overall inequality.<sup>21</sup>

McCarty, Poole, and Rosenthal’s argument that the relative position of the median voter has held steady has received a good deal of attention and, if true, would at least partially account for failure of a strong government response to rising inequality—“at least partially,” because it would still leave unexplained why policy *abetted* inequality. But we are convinced it is not true. Indeed, in light of the winner-take-all trends in income already discussed, it would take a truly massive influx of low-income immigrants to preserve the median voter’s relative position—far more than the actual increase in the foreign-born population from 4.7 percent of the U.S. population in 1970 to 10.4 percent in 2000.<sup>22</sup>

In reality, our own analyses of decennial census samples—which allow us to look at the relationship between citizenship and income using very large samples—indicate that the relative position of the median citizen has *declined* dramatically since the 1970s. As Figure 4 shows, taking into account immigration (the contrast between the dark line, which excludes noncitizens from the numerator, and the dotted line) makes only a minor difference in the relative standing of Americans in the middle of the income distribution.<sup>23</sup>

The second response to the inherent difficulties faced by the median-voter model is to amend the model. This is how we see much of Bartels’s innovative argumentation in *Unequal Democracy*. Bartels claims that voters recognize and are concerned about rising inequality (and, indeed, care more about economic issues than in the past), but have only a hazy idea of how inequality and policies pertaining to it affect them. He argues, for example, that Republicans have been able to win in spite of their presidents’ harmful effects on most voters because they are better at timing the business cycle, producing growth just before elections, for which myopic voters reward them. Yet because Bartels focuses so heavily on amending the median-voter model (with varying persuasiveness), he leaves largely unanswered the question of where the political pressure for less egalitarian policy outcomes come from. In other words, if voters do not run the show, who does, and how have those who do engineered such a profound policy shift? We will return to this question in discussing the source of political pressure that he and other political scientists who have examined rising inequality have largely overlooked—namely, shifts in the relative power and demands of organized interests.

**3.A thin conception of policy.** The third hallmark of existing political accounts is that they consider a very narrow range of policies—taxes, the minimum wage, perhaps fiscal and monetary policy—and make limited effort to assess the relative significance of particular policy instruments in generating distributional outcomes. As a result,



**Figure 4.** Citizenship and the median–mean ratio of family income, 1970–2000

Source: Authors' analysis of the 1970–2000 decennial census samples.

Note: To account for changing income topcodes, we cap family income at the ninety-ninth percentile—a level that is unaffected by the topcodes across this full period. All results are weighted to be representative of the population as a whole.

political accounts often have little to add to economic ones with regard to the role of government in influencing inequality.

To take a concrete example, one of the few policies that has received significant attention in these recent treatments of inequality is the minimum wage.<sup>24</sup> But while the declining value of the minimum wage certainly has distributional consequences and is clearly linked to politics, it is hard to see how an account of change in the minimum wage, no matter how persuasive, will get us very far in understanding the main distributional outcome that needs to be explained: the hyperconcentration of income at the top.

To be sure, in claiming that inequality ebbs and flows with the changing partisan identity of the White House, Bartels opens the door to an arresting argument about policy. We have already noted that Bartels's presidential partisanship story has serious problems explaining the sustained hyperconcentration of income since 1980, which has continued apace under both Republican and Democratic presidents. And it arguably ascribes to presidents more independent influence over macroeconomic policy than they actually enjoy in our system of checks and balances in which the president must vie with Congress and the Federal Reserve for influence. But the objection most relevant to the current discussion is that Bartels does not identify policies that can be plausibly linked the sustained run-up of top incomes. He suggests that the key tool

presidents use to change the income distribution is fiscal and monetary policy. Democrats prime the pump, so to speak, with the consequence that working-class income growth is higher under Democrats than under Republicans.

Such contractionary and expansionary initiatives, however, seem better candidates for explaining short-term fluctuations and patterns of income growth than long-term changes in the income distribution, especially sustained gains at the top rather than growth at the bottom. It is doubtful, for example, that the expansive fiscal and monetary policies that bump up lower income workers' employment and incomes could be sustained indefinitely. (Indeed, Bartels's argument about Republican success in producing growth just before elections rests on exactly this kind of short-term dynamic.) By contrast, long-term shifts in the income distribution are more plausibly linked to changes in the structure of the economy than to whether or not the economy is operating at peak output levels at any particular time. And yet the role of government policy in creating these larger structural changes is absent in Bartels's account (as it is in McCarty, Poole, and Rosenthal's).

4. *Where are organized interests?* Perhaps most telling of all given their broad aspirations, these recent efforts of political scientists to explain rising inequality pay strikingly limited attention to organized interests. In the two ambitious book-length analyses we have been discussing—books that represent the state of the art in contemporary American politics research—unions and corporations are hardly mentioned. (Unions have four references in the index of Bartels's book—two related to the minimum wage—while the National Election Study has twenty.) The idea that the shifting balance of organized interests might be relevant is almost altogether absent.

This near-complete absence is linked to another common feature of these analyses: none pays any real attention to comparative material as a source of insight or evidence. Although this is standard in contemporary research on American politics, it is highly revealing and consequential. When explaining change over time within American politics, analysts are drawn to the most obviously fluid features of a political environment: election outcomes, shifting public opinion, and so on. Broader features of the environment—systems of interest intermediation or what comparativists might call the "regime" of policy arrangements that structure the political economy—are essentially invisible. Lacking any reference to the often starkly contrasting circumstances in other affluent democracies, these features slip into the background.

In the next section, we outline an alternative political account that places organized interests and policy development at the center of the story. In doing so, we draw on extensive work in comparative political economy, as well as an older tradition of *American* political economy that has received limited attention within mainstream political science in recent decades.<sup>25</sup> Comparative scholarship has long insisted that conflict among organized interests is central to explaining the enormous cross-national and longitudinal variation in political and policy outcomes.

Yet while we build on prior this work in calling for renewed attentiveness to organized interests, we move beyond it in at least two key respects. Much of the comparative work has treated the United States as little more than a foil—a



distinctly “liberal” political economy in which policy efforts to ensure egalitarian outcomes are and have always been virtually nonexistent. But what we show is that these striking winner-take-all outcomes are of surprisingly recent vintage and reflective not only of longstanding features of U.S. politics and public policy, but also of substantial changes in policy that reflect equally substantial changes in the landscape of American politics.

In similar fashion, although we are indebted to work on American politics that has emphasized the influence of business power and the weakness of organized labor, we go beyond this work—which often portrays American politics as a more or less stable oligarchy of the wealthy—in identifying some of the key sources of variation in the power of organized interests, including the broader erosion of the organizational might of the middle class on economic issues. We also go beyond this work in carefully specifying the public policies that have resulted in growing inequality. The transmission of the influence of organized interests into distributional outcomes is not automatic; it runs through public policy—the ways in which government authority is exercised. Only through careful attention to policy and the process by which it is made can we understand how the power of organized interests is exercised and conditioned.

### **An Organizational-Policy Perspective on Winner-Take-All Inequality**

To sum up the main implications of the argument thus far: A convincing political account of American inequality must explain the defining feature of American inequality, namely, the stunning shift of income toward the very top. Equally important, it must explain how public policy has contributed to this trend. This means not only identifying public policies that can be linked to large increases in inequality; it also means providing an account of the political processes that have led to the generation of those policies.

These are not easy tasks. They require an understanding of the connections, often subtle, between policy structures and economic outcomes. Moreover, they require close examination of the political forces behind policy change. Depending on the policy involved, the relevant decision makers may be legislators, regulators, or presidents. New enactments may be required to shift policy. As we will see, however, policy change often occurs when groups with the ability to block change effectively resist the updating of policy over an extended period of time in the face of strong contrary pressure and strong evidence that policy is failing to achieve its initial goals—what we call policy “drift.”<sup>26</sup> These complex connections between political action and social outcomes are not likely to be established without sustained attention to the evolving content of public policies.

As we argued in the previous section, existing political accounts—while a vast improvement over the standard economic diagnosis—are not particularly successful in identifying plausible links among politics, policy, and rising inequality. McCarty, Poole, and Rosenthal focus on the way in which gridlock has prevented policy

updating in a few areas (the minimum wage, public assistance policies, the estate tax), but for the most part say little about how public policy has influenced rising inequality—and virtually nothing about how it has fueled the meteoric rise of top incomes. Bartels, for his part, fails to show how partisan control of the executive by itself could plausibly be connected to the dramatic rise in winner-take-all outcomes that has occurred since the late 1970s.

At the root of these weaknesses, in our view, is a conception of politics that focuses overwhelming on the voter–politician relationship—a view we call “politics as electoral spectacle.” By contrast, we believe the rise of winner-take-all inequality can only be convincingly explained with a very different perspective—which we call “politics as organized combat.” This alternative perspective is built around three central claims about how to understand the nature and politics of policy change. The first two specify more clearly how patterns of governance contribute to changes in key economic outcomes. The last indicates the critical political developments that drive changes in these patterns of governance over time.

### *1. Government Involvement in the Modern Economy Is Broad and Deep*

One of the reasons that political accounts are often greeted with skepticism is because they fail to identify policies that can be plausibly linked to large increases in inequality. More specifically, these accounts fail to identify policies that can be plausibly linked to large increases in inequality *before government taxes and transfers take effect*. As already noted, much of the rise in inequality at the very top has occurred in market incomes, or what income specialists (misleadingly) call “pre-tax-and-transfer inequality”—that is, income that people earn from their labor and capital prior to the effect of government taxes and benefits. The conclusion often taken from this is that market changes, not public policy, are driving the trend. On the conservative side, for example, Mankiw writes that while “some pundits are tempted to look inside the Beltway for a cause” of rising inequality, “policy makers do not have the tools to exert such a strong influence over pretax earnings, even if they wanted to do so.”<sup>27</sup> On the liberal side, UC Berkeley economist Brad DeLong says, “I can’t see the mechanism by which changes in government policies bring about such huge swings in pre-tax income distribution.”<sup>28</sup>

These conclusions overlook two crucial facts. First, as we will see, there is strong evidence that direct government tax-and-transfer policy *is* abetting inequality, especially at the very top of the income ladder. Second, and more important, this conclusion conflates pre-tax-and-transfer inequality with *pregovernment* inequality. The implicit view is that the market autonomously produces the distribution of economic rewards and only then does government step in to redistribute income. Yet government actually has an enormous range of tools for affecting the distribution of earnings before taxes and benefits take effect. Over the long run, government policies do not simply redistribute what labor and financial markets produce; they *structure* those markets in ways

that shape both economic outcomes and the capacity for organized action among economic interests. Policy helps to set the basic contours of the economy, the “variant of capitalism,” if you will.<sup>29</sup>

Most observers have paid little attention to the indirect ways in which government shapes the distribution of income—through what Nathan Kelly calls “market-conditioning” policies.<sup>30</sup> And even those scholars who, like Kelly, have noted the influence of government on the pre-tax-and-transfer distribution of U.S. market income have done little to investigate the specific ways in which government structures the economy. Yet, as we show later in this article, the rise of winner-take-all inequality in the United States is directly linked to the evolution since the 1970s of key areas of public policy governing corporate structure and pay, the functioning of financial markets, and the framework of industrial relations.

## 2. *The Transformation of Policy Occurs through Both Enactments and “Drift”*

A second oversight of existing political accounts is the presumption that if government played a central role in rising inequality, then a host of new laws and policies must have been created over the past thirty years to drive the upward distribution of income. Very important inequality-inducing laws and policies *have* in fact been created. But it is also important to recognize that major legislative initiatives—what David Mayhew, in his landmark study of divided government, calls “enactments”—are but one of the two principal mechanisms through which politics can reshape how an economy works.<sup>31</sup>

A second mechanism, which we call “drift,” is equally, if not more, important.<sup>32</sup> Drift describes the politically driven failure of public policies to adapt to the shifting realities of a dynamic economy and society. Drift is not the same as simple inaction. Rather, it occurs when the effects of public policies change substantially due to shifts in the surrounding economic or social context and then, *despite the recognition of alternatives*, policy makers fail to update policies *due to pressure from intense minority interests or political actors exploiting veto points in the political process*. Thus, drift requires (1) policies whose effects change due to shifting circumstances, (2) recognition of this change, (3) availability and awareness of viable alternatives, and (4) nonmajoritarian reasons why those alternatives are not adopted.

A prominent recent example of drift is the favorable treatment of the income of hedge fund managers. Remarkably, the astonishing fees these managers receive for investing other people’s money are taxed at a low capital gains rate rather than a much higher income tax rate. The basis for this favorable treatment is a set of obscure IRS rules adopted before hedge funds became a prominent part of the economy. Despite broad agreement that giving ultrawealthy hedge fund managers billions of dollars in tax breaks makes little policy sense, the financial industry has so far been able to resist efforts to update the rules to reflect new realities.

Three factors make drift an especially salient feature of the modern American political economy. The first is that the design of U.S. political institutions makes policy enactments especially difficult, while maximizing opportunities to pursue policy

agendas based on the exploitation of drift. Although there are multiple institutional obstacles to major policy reform, the most important in the last quarter century has been the Senate's requirement of sixty votes to cut off debate on proposed legislation. Between 1919 and 1969, 56 motions were filed to end a Senate filibuster. Between 1969 and the end of 2009, more than 1,100 were, with the overwhelming majority of these filed after 1991. The increasing use of the filibuster for partisan ends on left-right issues has allowed relatively small minorities (representing, at the extreme, just 11 percent of the population due to Senate malapportionment) to block action on issues of concern to large majorities of Americans.<sup>33</sup>

The second factor enhancing the prominence of drift is the increasing polarization of the two major political parties, which has fostered partisan stalemate even on issues that once featured cross-party bipartisan coalitions. Pundits often see gridlock as equal-opportunity stalemate, as deadly to attacks on existing programs as to calls for new public initiatives. But gridlock is not so neutral. First, the polarization of the two parties has been driven more by the move of the Republican Party to the right than the movement of the Democratic Party to the left, thus shifting the balance of partisan conflict to the right—despite little evidence of increasing conservatism in American public opinion over the period of rising polarization.<sup>34</sup> Second, in a context of dramatic economic change, polarization helps the cause of those who want to block reform, adding to the bias against government efforts to moderate rising inequality or respond to other emerging challenges in the private sector. In the American context, polarization has favored policy drift, and policy drift has encouraged the rise of winner-take-all.

A third factor in the rising significance of drift is that it provides an exceptionally valuable tool for policy makers seeking to be responsive to organized interests rather than disorganized voters. Compared with alternative mechanisms, drift allows policy change to occur through “nondecisions.”<sup>35</sup> It is thus less likely to attract the notice of those who pay only sporadic attention to politics and have limited information about policy. Conversely, it is quite easily seen and used by organized interests, such as the financial industry lobbyists defending the hedge fund tax break. We will have more to say about this important feature of drift shortly.

A convincing study of the American political economy, in sum, must pay central attention to the neglected but crucial process of policy drift. Understanding drift allows us to see how patterns of government action *and* inaction are integral to the development of the economy—the structuring of markets—over time. Equally important, an appreciation of the significance of drift helps us to get a handle on political processes behind the over-time transformation of public policy.

### *3. Shifts in the Balance of Organized Interests Are a Major Driver of Policy Change*

To analyze the political sources of rising inequality is to focus, first and foremost, on the exercise of *authority*. Politics is a contest where some gain the authority to make

decisions of fundamental significance for others. Especially in the modern era of activist government, those in positions of power can have an enormous influence on the distribution of economic rewards.

Given this, the center of the story is not elections but *policy*. For most of those engaged in politics over sustained periods, elections are only a means to an end: control over authority, or the capacity to make policies.

Gaining and using control over political authority requires organization. Influencing the exercise of government power in modern democracies necessitates a range of formidable capabilities: the capacity to overcome collective action problems, mobilize resources, develop extensive expertise, focus sustained attention, coordinate actions with others, and operate flexibly across multiple domains. By and large, these are the attributes of organizations, not discrete, atomized voters.

To be sure, voters wield real power thorough the ballot box. As the research of Bartels and many others has shown, however, voters' attention to the highly complex matter of what government actually does is limited, superficial, and typically brief. In our fragmented political system, victories without enduring organization are almost always fleeting. Struggles over policy—over what the government actually *does* for and to its citizens—are usually long, hard slogs. These are struggles that involve drawn-out conflicts in multiple arenas, extremely complicated issues where only full-time, well-trained participants are likely to be effective, and stakes that can easily reach hundreds of billions of dollars. Inevitably, organized groups are crucial actors, and usually *the* crucial actors, in these struggles.

Organized groups care deeply about elections, of course, and they try very hard to swing them their way. But they also are shrewd enough, and experienced enough, to place the competition for votes in proper perspective. This explains why only a small fraction of the billions that corporations spend on politics is directly connected to electoral contests. Most of the rest goes to lobbying expenditures—expenditures that have doubled in just the past decade.<sup>36</sup> For powerful groups the center of action is in Washington, not the swing states.

Once we are more attentive to the importance of organized interests and their relentless focus on what government actually does, it helps us to think differently about another crucial feature of modern politics: the two major parties, including their internal composition and the relationships between them. As Bawn and her coauthors argue, parties are not exclusively, or even primarily, marriages of convenience for teams of election-minded politicians seeking to appeal to voters.<sup>37</sup> They are also vehicles for carrying the concerns of coalitions of interest groups into policy making. Again, interests care about government because they care about the policies it produces. In turn, politicians (and parties) care about groups because they can mobilize resources that elected officials need. Moreover, groups combine these resources with intense preferences and substantial information. This combination of assets gives them unique capacities to reward and punish.

That interest groups seek to influence policy through the parties has two important implications for the study of political economy. First, major shifts in the overall

balance of organized interests are likely to exert effects on *both* major parties, although often in different ways. To be successful, politicians cultivate the support of organized interests that are capable of providing financial and other valued political resources. If the balance of power among interests shifts, politicians are likely to adjust their strategies and support coalitions.

The role of government in the political economy is not, therefore, just a question of the balance between the two parties, as Bartels's argument about the effects of partisan control of the presidency would suggest. Equally important is the matter of where the two parties situate themselves with respect to the most important issues of governance. This in turn is likely to depend on the shifting balance of organized interests. For instance, and again contrary to Bartels, we would emphasize that important elements of the Democratic Party have responded to the shifting balance of organized power by repositioning themselves on a number of critical issues, including taxation and deregulation, in ways that have undercut the party's traditional commitment to egalitarian policies.

The second implication is that parties often seek to be responsive to the concerns of policy-demanding interest groups even when this threatens to conflict with the preferences of the median voter. Indeed, this tension—as parties in government try to mediate the cross-cutting pulls of voter and organized interests—is central to modern governance.<sup>38</sup> *The art for policy makers is not to respond to the median voter; it is to minimize the trade-offs when the desires of powerful groups and the desires of voters collide.*

Because of the connection between electoral success and continuing access to authority, parties and interest groups have incentives to minimize the tension by finding low-cost/high-impact ways to support the demands of organized groups. Once again, this suggests careful attention to the distinct mechanisms linking policy making and policy outcomes. Precisely because the interests of groups are often in acute tension with the interests of voters, the effectiveness of groups is likely to be *least* evident in high-profile political episodes (although it may show up there as well). Instead, their effectiveness will be greatest in elements of the policy-making process that are unlikely to rouse the ire of inattentive publics while providing opportunities for these groups to exploit their organizational prowess, such as regulatory decisions and implementation.<sup>39</sup>

Organized groups will also be extremely active in the critical but understudied area of agenda setting, both to foster issues and frames that advance their interests and to keep troublesome issues off the table or at least block them before formal consideration. And groups will focus with similar intensity on what John Kingdon called “alternative specification.” They will seek to substitute symbolic actions for real ones, for example, or manipulate complex policy designs to produce more favorable yet opaque distributional outcomes.<sup>40</sup>

Perhaps most important, interest groups will seek to exploit drift to enshrine their preferences in policy. When the economic world is changing in ways that undercut undesired policy arrangements, they will encourage policy makers to simply sit on their hands. The benefits for interest groups can be massive, but the absence of action is

unlikely to attract sustained attention from voters or clear attribution to particular policy makers. Typically all sorts of reasons can be offered for why action failed to take place. For politicians, drift is generally the cheapest way to abandon the median voter.

Voters are hardly ignorant bystanders in American politics. But the role of voters is powerfully circumscribed and shaped by the organizational context within which their interests are formed and acted on. Voters need strong organizational mooring to recognize and respond to changes in public policy. Yet, as we will see, the organizational transformation that has strengthened business and weakened labor has been accompanied by an atrophying of the organizations that once brought less affluent Americans into politics and informed them about public policy debates. In the absence of these organizations, many voters are reliant on the media or parties themselves for basic information and cues, leaving them with much less reliable signals about which policies or candidates reflect their interests. It is revealing that, in opinion polls, Americans seem much less well informed about the distribution of income than citizens of other rich democracies, and in particular vastly understate the incomes of those at the very top.<sup>41</sup>

Especially important in this perspective is changing public trust in government and public officials. For many Americans, the sticking point in tackling inequality is not that they view inequality as good or necessary, but that they lack confidence in public officials' willingness or ability to address it effectively. Republican electoral inroads among moderate-income voters have occurred alongside not just declining organizational representation for these voters, but also declining public trust in government and a growing perception that politicians are excessively responsive to "special interests." We would argue that these voter perceptions, while having deep roots in American political culture, are also a reflection of the failure of public policy to respond consistently to the majority of voters on economic issues, due to the pull of organized interests, the increase in political polarization, and the fragmentation of American political authority. A set of findings that is broadly supportive of this argument has been produced by behavioral political scientists, including Bartels, who have shown that the votes of members of the Congress as well as the direction of national policy change are vastly more likely to reflect the preferences of higher income voters (as measured by polls) than those of voters lower on the economic ladder.<sup>42</sup> Another complementary finding is that the political participation and engagement of less affluent voters is generally lower in advanced industrial democracies in which economic inequality is greater (and in counties of the United States that are more economically disadvantaged).<sup>43</sup>

In emphasizing organized interests and the evolving structure of American political authority, we do not wish to deny that changes in ideas have played an important independent role in the restructuring of public policy over this period. The rise of neoclassical economics and increased emphasis on market-based policy prescriptions—as well as the broader ideological backlash against activist government—have clearly shaped the policy trends we describe. The rising prominence of these ideas, moreover, was in part the result of serious declines in economic performance

and corporate profitability in the 1970s that fueled doubts about existing policy arrangements and galvanized conservatives and business elites while lending credence to their concerns and proposed reforms.

As the force of the economic troubles of the 1970s suggests, however, the rise of conservative prescriptions did not occur in a political or organizational vacuum. Like Weber's "switchmen" on the tracks of history, we see the main role of promarket ideas as helping to provide intellectual backing for demands already voiced and to channel the shifts in the organized landscape of Americans politics just discussed into concrete policy changes. Indeed, a good number of the policy changes that we chart—such as the steep decline in marginal income tax rates beginning in the 1970s—occurred before the development of strong intellectual rationales for them. In many other instances (such as the example of hedge fund taxation), policies have been sustained or extended in the absence of any credible intellectual case or evidence. Thus, without denying the significance of the ideological developments of the 1970s and after, we give priority to the shifts in organized interests that both prompted and helped sustain many of these intellectual developments.

We return then to the central points of this section. To explain winner-take-all inequality requires attention to the specific features of public policies that have shaped not just explicit redistribution but also the distribution of seemingly natural market rewards, particularly at the top of the economic ladder. It also requires careful consideration of drift as well as major enactments. And it requires looking closely at the mechanisms through which organized groups try to influence the exercise of authority on all these fronts. In the next two sections, we offer an account of the rise of winner-take-all inequality that incorporates these elements. We begin with the restructuring of organized political activity in the United States over the last generation—a restructuring at the heart of the contemporary politics of inequality.

## **The Organizational Transformation of American Politics**

The emergence of the winner-take-all economy coincided with two widely recognized political shifts: the rise of a more powerful and conservative Republican Party and the dramatic increase in political polarization.<sup>44</sup> Another transformation has received far less attention: the balance of organized economic interests has shifted decisively in favor of employers and the affluent. Yet it is this profound organizational shift that may be of greatest significance for the politics of inequality.

### ***The Surge of Business Organization***

The decade of the 1970s brought a transition from a broad-based postwar settlement to a new politics of winner-take-all. The clearest marker of this shift was a remarkable expansion of business power. Always a major part of American political life, employers had encountered a series of unexpected defeats in the 1960s and early 1970s. Washington undertook a very dramatic expansion of regulatory power on issues from



the environment to occupational safety to consumer protection, driven in part by the emergence of new “public interest” organizations seeded by foundations.<sup>45</sup> As David Vogel summarizes, between 1969 and 1972 “virtually the entire American business community experienced a series of political setbacks without parallel in the post-war period.”<sup>46</sup> By 1971, future Supreme Court justice Lewis Powell felt compelled to assert, in a memo that was to help galvanize business circles, that the “American economic system is under broad attack.”<sup>47</sup>

The organizational counteroffensive was swift. The number of corporations with public affairs offices in Washington grew from 100 in 1968 to over 500 in 1978. In 1971, only 175 firms had registered lobbyists in Washington, but by 1982, 2,445 did. The number of corporate PACs increased from under 300 in 1976 to over 1,200 by the middle of 1980.<sup>48</sup> Of greater political significance was the expansion of the collective capacities of employers, allowing them to mobilize more proactively and on a much broader front. The Chamber of Commerce—for whom Lewis Powell, as chair of the Chamber’s Education Committee, penned his influential memo—doubled in membership between 1974 and 1980. Its budget tripled. The National Federation of Independent Business doubled its membership between 1970 and 1979. The Business Roundtable, designed to mobilize high-level CEOs for the advancement of shared interests, formed in 1972. The National Association of Manufacturers moved its main offices to Washington. As its chief observed,

We have been in New York since before the turn of the century, because we regarded this city as the center of business and industry. But the thing that affects business most today is government. The interrelationship of business with business is no longer so important as the interrelationship of business with government. In the last several years, that has become very apparent to us.<sup>49</sup>

The role of the business community not only grew, but expanded. Employers and wealthy families poured vast new resources into politics—not just to lobby on particular bills, but to shape the broader political climate. Especially prominent in these efforts were wealthy Sunbelt activists. Staunch economic conservatives and fiercely critical of the basic contours of the post–World War II domestic settlement between labor and industry, they nurtured an interlocking system of new foundations and think tanks—organizations that saw their role as shifting public opinion and public policy in a conservative direction through aggressive communication efforts.

Recognizing that lawmaking in Washington had become more open and dynamic, business groups remade themselves to fit the times. Ironically, the expanding network of business organizations hoisted the public interest groups on their own petards. Using rapidly emerging tools of marketing and communications, they developed their capacity to generate mass campaigns. Building networks of employees, shareholders, local companies, and firms with shared interests (e.g., retailers and suppliers), they could soon flood Washington with letters and calls. Within a few years, these classically

top-down organizations were to thrive at generating bottom-up-style campaigns that not only matched the efforts of their rivals, but surpassed them.

These emerging “outside” strategies were married to “inside” ones. Business organizations developed lists of prominent executives capable of making personal contacts with key legislative figures. In private meetings organized by the Conference Board, CEOs compared notes and discussed how to learn from and outmaneuver organized labor. In the words of one executive, “If you don’t know your senators on a first-name basis, you are not doing an adequate job for your stockholders.”<sup>50</sup>

From 1965 to 1975, the pendulum swung away from business. In the next few years, it swung back. In the following quarter-century, however, *it stayed firmly in place*. There have been occasional zigs and zags. Environmental groups, for instance, gained new members on the strength of reaction to Reagan’s policies. The right, including Christian conservatives, mobilized in response to the Clinton administration. But the increasing political capacity of business continued for a generation and, indeed, has only intensified. The scale of lobbying—a sector of political life that is overwhelmingly the territory of corporations—has dramatically increased since the mid-1990s, dwarfing the amount contributed to campaigns. But campaign giving is also a major part of the story, with differing implications for the two parties.

### *Business Political Giving and the Parties*

As its organizational clout grew, business also massively increased its political giving. Moreover, it did so at precisely the time when the cost of campaigns began to skyrocket (in part because of the ascendance of television). The insatiable need for cash gave politicians good reason to be attentive to those with deep pockets—and business had by far the deepest.

Business gave generously to politicians of both parties from the mid-1970s to the mid-1980s. But as the journalist Thomas Edsall has observed, this should not be treated as an indication of nonpartisanship, because business was actually treating the two parties very differently.<sup>51</sup> What money business gave to Democrats went almost exclusively to incumbents, especially moderate-to-conservative ones. Republican incumbents got money too, but the GOP also received a great deal of corporate money for party-building efforts. Individual Democratic incumbents could finance their reelection bids, but the difference in the financial resources—and hence the organizational capacities—of the parties as organizations became massive in this period.

The targets of business largesse in the two parties differed because the donations served different purposes. Financing the GOP was an investment. Business money nurtured a cadre of elected officials committed to advancing a deregulatory and tax-cutting agenda. It also increased the capacity of the Republican Party to gain power and make the case for free markets. Corporations and wealthy individuals bankrolled a party infrastructure committed to advancing a business agenda, refining messages for public consumption, and marketing them energetically.

Fueled in part but not exclusively by business support, the Republican Party's key organizations built a massive advantage over their Democratic counterparts beginning in the mid-1970s.<sup>52</sup> Within a decade, the GOP had built what Gary Jacobsen, a leading scholar of congressional elections, called "by far the strongest national party organization in American history."<sup>53</sup> By the mid-1980s, Republican national party organizations could outspend Democratic ones five to one. Among other things, this organizational and financial edge allowed them to target money effectively in campaigns. As Robert Kuttner has noted, "[B]etween 1978 and 1984, the heyday of the Republicans' technological lead, there were twenty-four U.S. Senate races where the winner squeaked in with 51 percent or less. Thanks to superior targeting techniques and the ability to pour in late money selectively, the Republicans won nineteen of these, or nearly 80 percent."<sup>54</sup> In 1982, a deep recession threatened to produce a backlash election that might have stopped the "Reagan Revolution" in its tracks. According to Jacobson, the GOP's financial and organization edge played a critical role in reducing Republican losses in the House from a disastrous potential loss of sixty to a manageable twenty-six.<sup>55</sup>

The need of the Democrats to respond to this formidable organizational machine encouraged them to adopt a more accommodative stance toward business. And business money did flow to Democrats, though in different ways and for different reasons. If money to the GOP was an investment, money to Democrats was a form of insurance. Revealingly, the money went largely to individuals rather than to the party as an organization. It was destined for the powerful and "moderates." As the prominent business lobbyist Charls Walker put it, corporate PACS were "very important in affecting ideological balance in Congress. Members now have alternative places to look for campaign contributions."<sup>56</sup>

The main goal of channeling money to influential or swing Democrats was to minimize any prospect of distasteful legislation. Put more precisely, these efforts were designed to facilitate policy drift. Carefully targeted contributions could effectively exploit the multiple channels American political institutions make available for diversion, dilution, or delay. Even grudging or quiet support from a handful of Democrats—particularly well-placed ones—could make a huge difference. Such allies could help keep issues off the agenda, substitute symbolic initiatives for real ones, add critical loopholes, or instigate unnecessary compromises with the GOP. Willing Democrats could also provide valuable bipartisan cover for business-friendly Republican initiatives.

In short, the newly mobilized business groups understood that Democrats and Republicans could play distinct but complementary roles in fostering the politics of winner-take-all. Clifton Garvin, chairman of both Exxon and the Business Roundtable in the early 1980s, summarized the attitude toward partisanship this way: "The Roundtable tries to work with whichever political party is in power. We may each individually have our own political alliances, but as a group the Roundtable works with every administration to the degree they let us."<sup>57</sup>

The extraordinary increase in the political capacities of business organizations was the central story in Washington in the mid- to late 1970s. In a few short years, business went from panic to preeminence. Cries of anguish from the corporate elite gave way, in the words of a *Newsweek* reporter, to sounds of “purring.” Tellingly, the reversal in governance—defeat of health care and labor law reform, the crushing of efforts to establish a consumer protection agency and index the minimum wage to inflation, the beginnings of the deregulation revolution, and, most dramatically, a major tax bill anchored by steep cuts in the capital gains tax—all occurred during the late 1970s, at a time when Democrats held the White House and had large majorities in both houses of Congress. The broad advance of this business agenda *prior to Reagan’s victory* provides telling evidence that much of governance is a matter of organized combat rather than electoral spectacle.

### *The Decline of Middle-Class Organization on Economic Issues*

The shifting contours of organized combat were not exclusively a matter of corporate mobilization. While the new clout of business represented the biggest development, it was just one of a number of transformations within the universe of organizations contesting for political influence. These developments were diverse, and flowed from a variety of forces in American society. They included everything from the continuing growth of public interest groups in areas like the environment, feminism, and civil rights to the rise of Christian conservatism. Yet there was a common theme linking these disparate trends: all of them worked to diminish the presence of organized voices addressing the *economic* concerns of ordinary Americans in Washington.

We focus here on three primary causes of this transformation: the decline of labor, the shift away from mass-membership, locally rooted political organizations toward centralized mailing-list, D.C.-based groups (with the notable but revealing exception of Christian conservatism), and the increasing importance of money in American political life.

Second only in importance to the ascent of business was the continuing decline of organized labor. Of course, by international standards the United States has long been distinguished by weak unions. Even from a relatively modest starting point, however, the scale of their decline over the past few decades remains astonishing, and far more severe than what has transpired in the majority of market economies. In the decade after World War II, more than one-third of wage and salary workers in the United States were in unions. By 2009 the share had dropped to 12.3 percent, and just 7.2 percent in the private sector.<sup>58</sup>

Economists often focus on unions’ contribution to greater equality through their bargaining over wages. This is a mistake. It is the *political* role of organized labor on issues of economic and social policy that matters most in the political economy. Indeed, the political consequences of union power are difficult to exaggerate. Social scientists have consistently shown that the strength of organized labor has a very large impact on the development of social policies across nations. Strong labor unions are

closely associated with low levels of inequality and more generous social programs.<sup>59</sup> In the American context, unions represent by far the most significant organized interest with a sustained stake in the material circumstances of those with modest means. The decline of organized labor has greatly diminished the pressure on policy makers to sustain or refurbish commitments to social provision made in the middle decades of the last century.

This profound organizational shift, with labor declining at the same time that business greatly expanded its reach, receives remarkably limited discussion among students of American politics. Moreover, the impact of the change on the American political economy has been reinforced by other developments in the organizational universe. Labor union decline has been just one component (although probably the most important one) of what Theda Skocpol has demonstrated was a broader transformation of political organizations since the 1960s: a shift from “membership to management.”<sup>60</sup>

With one major exception that we will discuss in a moment, mass-membership organizations with true grassroots presence have atrophied. In their place have arisen Washington-based advocacy groups with professional management teams and mailing-list memberships. Some of these are “Astroturf” organizations, purporting to be broad based but in actuality run by industry lobbyists. Others may have memberships in the hundreds of thousands, but the participation of these members is limited to writing a check in response to expertly designed solicitations from headquarters. Organizations that once carried the economic concerns of ordinary citizens to Washington—not just unions, but fraternal societies, broad civic organizations, and strong local party operations—have largely lost their role in national politics.

To be sure, the shift from “membership” to “management” has not pushed politics consistently in one ideological direction.<sup>61</sup> New “public interest” organizations, organized around the environment and other single-issue causes associated with the left of the political spectrum, have proliferated.<sup>62</sup> But it is not just an issue of “left” versus “right.” Rather, it is an issue of the capacity of working- and middle-class citizens to find organized expression of their economic interests. The shifts on both the left and right have worked to mute that expression.

On the left, the ascendant organized groups within the liberal coalition have become a critical base of support for the Democratic Party. For instance, the group Emily’s List, which supports women candidates for elective office, has become one of the single largest sources of financial support for Democratic candidates. Yet with respect to governance, these groups have almost *never* focused their attention on the economic issues that most powerfully affect the working and middle classes. Their concerns, such as environmentalism, women’s rights, and civil liberties, are instead largely those of the most affluent members of the Democratic Party.

Even where the potential for a strong focus on economic disadvantage seems evident, as with groups advancing the concerns of minorities and women, D.C. organizations have tended to give such matters low priority. The authors of a recent comprehensive study of lobbying marvel at “the relative paucity of issues relating to the poor and to the economic security of working-class Americans” on the lobbying

agenda of even public interest groups. They conclude that while lobbyists for the affluent “do not always win, corporate, professional, and trade interests have a distinct advantage in setting the lobbying agenda” and “that the inequities of social class are sharply exacerbated by the organizational bias of interest-group politics.”<sup>63</sup> We would only add that this exacerbation has grown considerably more pronounced in the era of winner-take-all inequality.

We mentioned that there was one exception to the trend away from grassroots organization with a solid footing in the working and middle classes. That exception—and it is a very big one—is the rise of Christian conservatism. Yet ironically, it is an exception that has strongly reinforced the overall trend. By engaging these voters in politics on explicitly nonmaterial grounds and aligning a large group of moderate-income voters with a political party highly attuned to the economic interests of the wealthy, this development has intensified the broad organizational shift in American society away from middle-class economic concerns.

Of course, the impact of this development can be exaggerated. As Bartels and others have convincingly argued, the rise of a more conservative American political establishment does not seem to reflect an eclipse of economic concerns by “moral issues.”<sup>64</sup> Instead, voting has become more class stratified than it was in the long period of prosperity that followed World War II. Yet it is still the case that the votes of evangelicals “tip” to the Republican column at a much lower income level than similar voters who do not identify as evangelicals. They do so, in part, because the groups that help bring Christian conservative voters to the polls do so explicitly around moral issues rather than economic ones. The leaders of the Christian right have formed an alliance, through the Republican Party, with powerful interests deeply committed to advancing a winner-take-all economy—another example of how the group basis of the parties profoundly matters for the choices of voters.

One final shift in the organizational terrain has also been critical: the organizational routines of American politics have been monetized. Campaigns have become more focused on media and advertising, and thus more preoccupied with the huge sums of funds needed to make such efforts. In response, politicians have turned to affluent donors and organized interests as never before to finance these spiraling costs. The parties, for example, now contact between one-quarter (Democratic Party) and one-third (Republican Party) of the wealthiest of Americans directly during campaign seasons, up from less than 15 percent of these high-income voters in the 1950s.<sup>65</sup>

Moreover, this has happened at exactly the same time that American society has grown much more unequal. As donors to campaigns and causes and political activists in their own right, America’s growing class of superrich simply cannot be ignored. And while they can be found at all points on the political spectrum, the rich have distinctive policy preferences on economic issues. Though few surveys reach enough truly rich Americans to form reliable inferences about the political preferences of the extremely well-off, what evidence there is suggests that the rich are more conservative economically—less supportive of economic redistribution and measures to provide economic security—and, on average, better informed about policy than are ordinary

Americans.<sup>66</sup> One survey regarding the 2003 tax cuts, for example, found that the wealthiest were both more supportive of and more informed about the dividend and capital gains tax cuts.<sup>67</sup>

The growing influence of money in politics has generally been helpful to Republicans. The money chase reinforces the GOP's low-tax, limited-government message. For the Democrats on the other hand, it introduces major cross-pressures, giving them a strong incentive to reduce their focus on issues of redistribution and economic security to appeal to affluent voters and moneyed groups as sources of campaign cash.

The marked changes in the organizational universe over the past generation contain many complexities. Yet the net effect of these diverse organizational shifts—the increasing organizational capacity of business, the decline of unions, the replacement of grassroots organizations with Washington-based managerial ones appealing to the affluent, the growing organizational clout of Christian conservatives, and the ever-increasing presence of big money in political life—is actually straightforward: they have dramatically weakened the *organized* political voice of ordinary citizens on economic issues. Mass-membership organizations representing the economic interests of voters from the middle to the bottom of the economic ladder, always weak, have atrophied further, while the capacity of employers, other business-linked interests, and the affluent in general has greatly increased. In the next section, we suggest that these changes have had a substantial impact on public policy.

## Government's Reshaping of the American Economy

If the politics of electoral spectacle is about winning elections, the politics of organized combat is about transforming what government does. Did the shifting balance of organized interests lead to major changes in the governance of the American political economy? The answer is yes, and in this section, we document these changes in four crucial policy arenas: taxation, industrial relations, executive compensation, and financial markets.

Although this effort is preliminary, we seek to make a plausible case for two claims. First, there is substantial evidence that policy developments of the past three decades—through both enactments and drift—have made a central contribution to the surge of winner-take-all economic outcomes in the United States. Second, there is also substantial evidence that organized interests were highly motivated, mobilized, and involved in many of these developments.

### Taxes

Any political analysis of rising inequality must be attentive to tax policy. Taxes represent perhaps the most visible way in which policy makers influence the distribution of income. Furthermore, even casual observers are aware that policy since the Reagan administration has often involved significant tax cuts for the well-to-do. Yet crucial

questions remain unanswered—questions we will address with regard to all four of the policy areas we examine. How big has the policy shift been? Has it made a significant contribution to rising inequality? Who exactly has benefited? Moreover, what does the pattern of policy change suggest about political dynamics? When, and through what mechanisms, has policy changed?

Thanks to extremely important work by Thomas Piketty and Emmanuel Saez, we are now in a much better position to answer some of these questions.<sup>68</sup> Building on their research on changes in outcomes at the top of the income distribution, Piketty and Saez have generated stunning data on the changing structure of federal taxation. Their data make it possible to parse outcomes for relatively small groups within the top 1 percent. Moreover, the data cover *all* of the major federal taxes—income, payroll, estate, and corporate—generating a much broader view of policy change than previously possible. Perhaps most important, the data allow Piketty and Saez to investigate tax *incidence*—not just changes in the marginal rates in the tax code (which have figured prominently in the discussions of political scientists) but the actual tax levels that households pay once deductions and other maneuvers are taken into account.

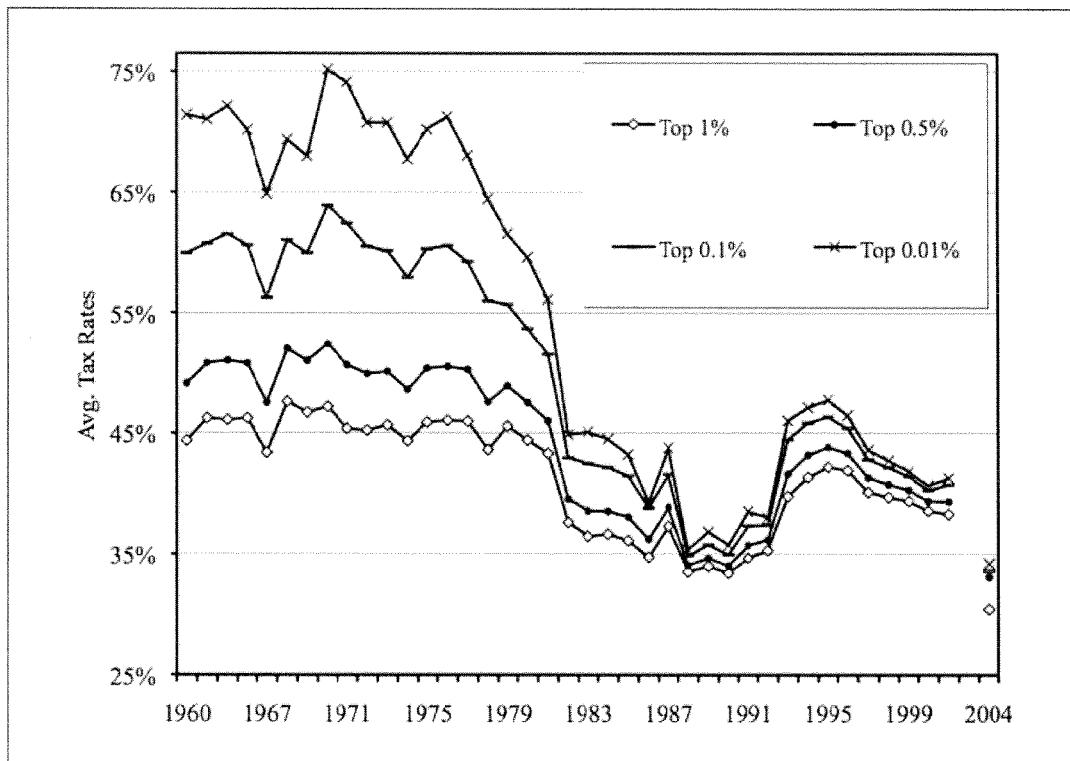
Piketty and Saez's results, presented in Figure 5, are striking in several respects. First, they suggest that the role of taxes in rising inequality is much more pronounced if one concentrates on the very top income groups. As they put it, "[I]t is important to decompose the top of the income distribution into very small groups to capture the progressivity of the tax system."<sup>69</sup> The changes of the tax rate for those at the ninetieth percentile, and even the ninety-eighth percentile, have actually been quite modest over the past four decades. By contrast, there have been startlingly large changes for those in the top 1 percent. This is mostly because of the declining role of the corporate income tax and the estate tax. *Progressivity used to be very pronounced at the very top of the tax code; now it is almost entirely absent.* As Piketty and Saez summarize their findings, "The 1960 federal tax system was very progressive even within the top percentile, with an average tax rate of around 35 percent in the bottom half of the top percentile to over 70 percent in the top 0.01 percent."<sup>70</sup>

Second, not only has the shift in policy been highly concentrated on the very affluent, the magnitude of the shift is quite large. Again, Piketty and Saez,

[T]he pre-tax share of income for the top 0.1 percent rose from 2.6 percent in 1970 to 9.3 percent in 2000. The rise in after-tax income shares was from 1.2 percent in 1970 to over 7.3 percent in 2000. In percentage point terms, the increase in pretax incomes is slightly greater than the increase in posttax incomes. But in terms of observing what those with very high incomes can afford to consume, the after-tax share of income for those in this income group multiplied by a factor of 6.1, while the pretax share of income multiplied by a factor of 3.5. The tax reductions enacted in 2001 and 2003 have further weakened the redistributive power of the federal income tax today.<sup>71</sup>

One can ask, counterfactually, what if the gap between pre- and posttax income of the top 1 percent had not declined since 1970? According to Piketty and Saez, the top 0.1





**Figure 5.** Average tax rates for top income groups, 1960–2004

Source: Thomas Piketty and Emmanuel Saez, "How Progressive Is the U.S. Federal Tax System? A Historical and International Perspective," *Journal of Economic Perspectives* 21, no. 1 (2007): 3–24.

percent had about 7.3 percent of after-tax income in 2000. If the gap between their pre- and posttax income had remained what it was in 1970, they would have had about 4.5 percent of after-tax income. In other words, *changes in tax incidence account for roughly one-third of the total gains in income share for the top 0.1 percent in the last four decades.* (Moreover, this is just the direct effect of the decline in effective taxation at the top. Many experts believe the rise in executive pay that we will discuss in a moment has been fostered indirectly by the decline, which has increased the confidence of compensation boards that executives will reap much of the astronomical salaries that boards grant.)

Equally striking is the enduring nature of the policy shift. Although the early years of the Reagan administration figure prominently, the change began in the 1970s. The initial drop came through large cuts in the capital gains tax and other taxes on the well-to-do passed, after very intense business lobbying, by a Congress composed of large Democratic majorities in both chambers and signed into law by a Democratic president.

Moreover, it is difficult to trace these developments to any straightforward shift in public opinion regarding taxation.<sup>72</sup> Research on both the tax cuts of the early 1980s and those of the past few years suggest that organized interests have played a prominent role, both in keeping tax cuts on the agenda and shaping policy to focus the gains

of tax-policy changes on those at the very top of the income distribution.<sup>73</sup> The rise of supply-side economics, with its emphasis on the negative effects of high marginal tax rates on the well-off, surely helped the progress of tax cuts. Yet the supply-side rationale actually gained credence only *after* the initial flurry of tax cuts in the 1970s, and it was largely exhausted as a serious intellectual force by the time the Bush administration and congressional Republicans slashed upper-income taxes in the early 2000s.

A number of specific developments within the broad arc of tax policy making suggest an impressive focus on directing benefits not just to the very well-to-do (say, the bottom half of the top 1 percent) but to the superrich. David Cay Johnston provides copious evidence, for example, that there has been a steep decline, encouraged by Congress, in IRS oversight of high-income returns, combined with a politically induced shift of resources to oversight of Earned Income Tax Credit returns of the poor and lower middle class.<sup>74</sup> Studies of specific battles over the estate tax and the alternative minimum tax have suggested that policy makers repeatedly chose courses of action that strongly advantaged the very wealthy at the expense of the much larger group of the merely well-to-do.<sup>75</sup> In all these accounts, the influence of organized interests—particularly lobbyists representing business and the wealthy, conservative antitax groups such as Americans for Tax Reform, and free-market think tanks like the Cato Institute—loom much larger than the sway of voters or pull of general public sentiment.

The shift toward a much more favorable tax regime for the wealthy has occurred largely through policy enactments. The bulk of these have occurred under Republican congressional majorities and Republican presidents (although often with significant Democratic support). However, there have been revealing cases of drift as well, such as the aforementioned protection of extremely favorable tax rules for hedge fund managers. Although their extraordinary incomes are at the very top of the distribution these financiers have been able to exploit features of tax law that predate the rise of hedge funds. “Carried-interest” provisions allow these managers to treat the spectacular fees they are paid as capital gains, subject to only a 15 percent tax rate. Although this loophole is widely viewed as indefensible, it has been successfully protected for years through the strong backing of Wall Street supporters like Senator Chuck Schumer of New York.<sup>76</sup> President Obama’s 2010 budget proposal calls for repeal of the carried-interest provisions, but crucial Democrats such as Max Baucus, chair of the Senate Finance Committee, have already indicated that they are in no hurry to act on this suggestion.

### *Industrial Relations*

The evolution of industrial relations in the United States provides the second crucial chapter in the tale of winner-take-all inequality’s rise. Research in comparative political economy has long maintained that the organization of relationships between employers and workers is of fundamental significance for a wide range of economic interactions. For good reason: there are wide and highly consequential differences in

these arrangements within the universe of affluent democracies that have been repeatedly linked to major distributional and market differences across nations.

The United States has always stood out on measures of union strength as a nation with a weak organized labor movement. Nonetheless, over the past three decades, the structure of American industrial relations has changed profoundly. Union density—the share of the workforce covered by collective bargaining—has fallen precipitously, especially in the private sector. From organizing roughly one-third of the workforce, union organization has fallen to under one-tenth of private sector employees.

Although an enormous body of work in comparative politics suggests that such a transformation should have dramatic consequences, the subject receives little attention in the emerging literature on American inequality—especially and most strikingly in works that focus on politics. Typically, the virtual collapse of private sector unionism is dismissed as nonpolitical, relatively modest in its impact, or both.

To be clear, some scholarly observers have forcefully argued that the decline of unions plays an important role in growing wage inequality. At least among men, union workers earn higher wages than their otherwise similar compatriots.<sup>77</sup> Wage inequality is greater in the lower half of the income distribution in the United States than it is in any other affluent democracy.<sup>78</sup> Yet comparative analyses suggest that such a narrow empirical focus is likely to drastically understate the impact of unions. Organized labor's role is not limited to union participation in wage-setting. Much more fundamental is the potential for unions to represent an important organizational counterweight to economic and political power at the top.<sup>79</sup> Indeed, in the American context it is worth stressing again that while there are many "liberal" groups in the universe of organized interests, *labor is the only organized interest focused on the broad economic concerns of those with modest incomes.*

A broader view highlights at least two important ramifications of union power. First, unions have the capacity to play an important role in corporate governance.<sup>80</sup> At least under certain institutional conditions, they have the resources and incentives necessary to provide a check on the scale of executive compensation, and to push for compensation designs that align executive incentives more closely with those of their firms. Indeed, even with their current weakness, American unions (through operations like the AFL-CIO Office of Investment) represent one of only two organized interests providing a potential check on managerial autonomy—the other being "investor collectives" like public employee pension systems and (more problematically) mutual funds.

Second, unions may play a significant role in political conflicts related to the distribution of income. On the one hand, they may push policy makers to address issues of mounting inequality. On the other, they may recognize, highlight, and effectively resist policy changes that further inequality. Consider just one example of how the contemporary weakness of organized labor shows up in recent policy developments. Well over a thousand registered lobbyists in Washington identify taxes as one of their areas of activity. Yet during recent fights over the estate tax—a policy issue with large and obvious distributional consequences—organized labor could supply only *one*

union lobbyist to address the issue.<sup>81</sup> Amazingly, even this lobbyist was available only quarter-time to work on *all* tax issues. In fact, the biggest organized opposition to estate tax repeal came not from organized labor but from a group of billionaires led by William Gates Sr. (Bill Gates's father). It is hard to imagine a more telling illustration of the existing organizational inequalities in Washington on economic issues.

Even if one accepts labor's potential significance for politics and policy making, however, there is the issue of how to account for union decline. Many would maintain that the decline of unions in the United States is almost exclusively a market phenomenon. Unions are fading, it is often suggested, because of changes in the global economy that relentlessly send their jobs overseas. Yet as in so many aspects of the subject of inequality, a comparative view casts doubt on the idea that market imperatives are the only story, and that extreme union decline in the private sector is inevitable. While unions have declined in significance in many Western nations, their presence has fallen little or none in others.<sup>82</sup> And one of those nations has the virtue for comparative analysis of being otherwise quite similar to the United States—namely, Canada. Once more limited in reach than their American counterparts, Canadian unions now enjoy much broader membership (about one-third of the nonagricultural workforce) and have seen little decline—despite similar worker attitudes toward unions in the two nations (Table 2).

The contrast with Canada suggests the possibility that fall in union density has been in significant part a political process. And indeed there is considerable evidence this is the case. Popular advocates of this view would stress events like Ronald Reagan's efforts to break the strike by air traffic controllers (PATCO), as well as changes in the composition of the National Labor Relations Board after his election. As Henry Farber and Bruce Western have cogently argued, however, a heavy emphasis on these overt initiatives is difficult to reconcile with a close examination of the timing and patterns of union decline.<sup>83</sup>

Our own account would emphasize alternative policy mechanisms and focus on the consequences of government inaction rather than action. During the recent transformation of the American political economy, the evolution of industrial relations is perhaps the most consequential instance of policy drift. The absence of an updating of industrial relations policy has had brutal effects on the long-term prospects of organized labor. It is well understood that the American industrial relations system contained certain structural features that gravely threatened unions after the 1960s.<sup>84</sup> Well established in certain manufacturing industries in particular states, unions were acutely vulnerable to the movement of manufacturing jobs to states where labor rights were more limited, as well as shifts in employment to sectors that had not previously been organized.

An updating of industrial relations policy could have addressed some of these weaknesses. Careful comparison with Canada is revealing. As Table 2 suggests, the two union movements diverged dramatically in their capacity to cope with a shifting economic environment. The Canadian economist W. Craig Riddell has found that little of the divergence can be explained by structural differences in the two nations' economies, or

**Table 2.** Union Share of Wage and Salary Workers in the United States and Canada

	United States (%)	Canada (%)	Percentage point difference
1960	30.4	32.3	1.9
1970	26.4	33.6	7.2
1980	22.2	35.7	13.5
1990	15.3	34.5	19.2
2000	13.5	32.4	18.9
2005	12.5	32.0	19.5

Sources: David Card, Thomas Lemieux, and W. Craig Riddell, "Unionization and Wage Inequality: A Comparative Study of the U.S., the U.K. and Canada" (Working Paper 9473, National Bureau of Economic Research, Cambridge, MA, 2003); Sylvia Allegretto, Lawrence Mishel, and Jared Bernstein, *The State of Working America* (Ithaca, NY: Cornell University Press, 2008); and Statistics Canada. Labour Force Historical Review 2008 (Table Cd3T09an). Ottawa, Statistics Canada, 2009 (Cat. No. 71F0004XCB).

even by differing worker propensities to join a union.<sup>85</sup> Rather, the difference is due to the much lower (and declining) likelihood in the United States that workers who have an interest in joining a union will actually belong to one. There is considerable evidence that differences in labor law are a major part of the explanation. Prominent institutional differences include Canadian practices that allow for card certification and first-contract arbitration, ban permanent striker replacements, and impose strong limits on employer speech.<sup>86</sup> Meanwhile, aggressive antiunion activities by employers in the United States have met little resistance from public authorities.

Union leaders during this period are often portrayed as having had their heads in the sand. In fact, initial complacency gave way to aggressive attempts to seek reforms. The emerging system of winner-take-all politics, however, responded with paralysis and policy drift. The most prominent political struggle surrounded a major labor law reform bill in 1978. Unions made this their top political priority. As Vogel recounts, employers energetically countermobilized.<sup>87</sup> Reform passed the House and commanded majority support in the Senate, but in a sign of the gridlock that would soon seem normal, the bill's opponents were able to sustain a filibuster. This occurred despite the presence of large Democratic majorities in the House and Senate as well as a Democratic president, as many Democrats supported the Senate filibuster.<sup>88</sup>

Labor's defeat in this pitched battle had major ramifications, as participants drew the appropriate lessons. It made it more difficult for labor to rally political support in future struggles. In Frank Levy and Peter Temin's words, it sent "signals that the third man—government—was leaving the ring. From that point on, business and [labor] would fight over rewards in [a] free market with most workers in an increasingly weak position."<sup>89</sup> Even before Reagan took office, business adopted a much more aggressive posture in the workplace, newly confident that government would not intervene. Strike rates plummeted, and many of the strikes that did occur were acts of desperation rather than indicators of union muscle.<sup>90</sup>

In short, the severe decline of organized labor in the United States was in part a *political* outcome, driven by new antiunion enactments as well the failure to update

policy to reflect the increasing relative strength of employers in a more global, service-oriented economy. There were policy alternatives that would have reduced the decline, and that had advocates within the United States. The opponents of such reforms, possessing formidable and growing organizational resources, mobilized effectively to stop them. They then used their organizational resources to exploit the resulting drift and launch a vigorous assault on American labor, with effects felt not just in the economic sphere but also in American politics.

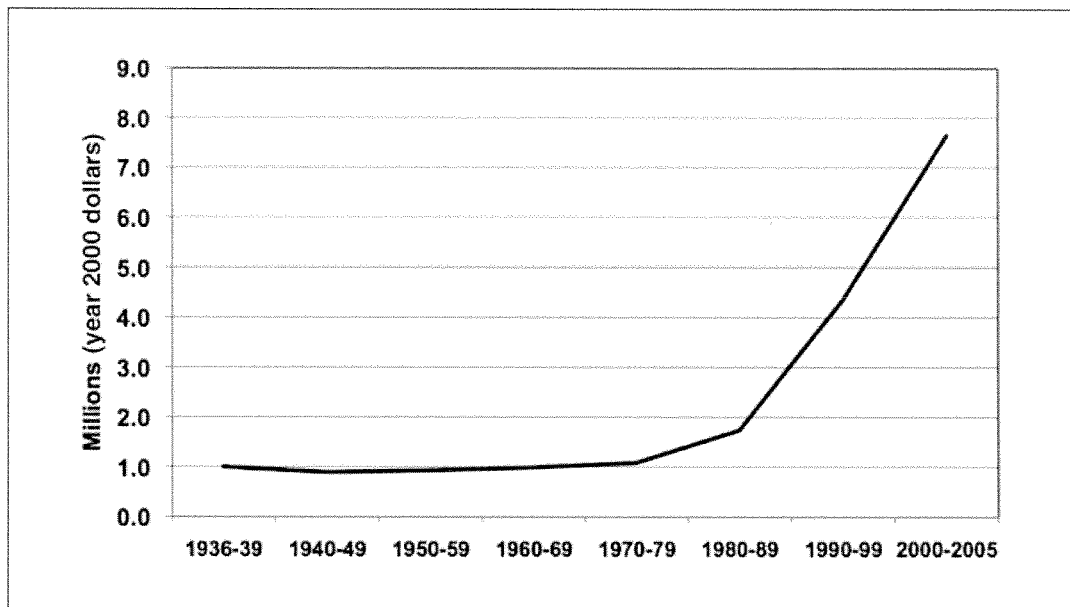
### *Corporate Governance and Executive Compensation*

While changes in taxation and the reach of unions are obviously germane to inequality, the case for discussion of corporate governance requires some defense. No one disputes that rising executive pay has played a central role in mounting American inequality. Although it is difficult to generate precise numbers, Piketty and Saez suggest that perhaps half of the pretax gains of the top 1 percent reflect the explosion of executive compensation.<sup>91</sup> Figure 6 shows the development of total compensation for the top three executives at the nation's largest firms since the mid-1930s. As the figure shows, executive pay skyrockets after 1980, with the largest increases coming in the 1990s.

Here we enter a sphere that Americans have typically treated as outside of politics, but which comparative evidence suggest is strongly influenced by patterns of political contestation.<sup>92</sup> Cross-nationally there is tremendous variation in corporate governance practices and in economic outcomes. Rising executive compensation is much more evident in Anglo countries than in other rich democracies, and most evident of all in the United States. Compensation structures remain much different in most of the advanced industrial world than they are in the United States. For instance, where stock options are used, they are often linked to long-term rather than short-term performance, as well as to firm performance relative to industry norms. Thus, for example, when a rising price of oil drives up the share price of energy companies, CEOs would receive extra compensation only if their firm's performance exceeded industry averages.

The rise in executive pay seems related to a broader shift in structures of corporate governance, ostensibly toward maximization of "shareholder value" but arguably toward what Peter Gourevitch and James Shinn call "managerism," in which opportunities for well-positioned elites to extract resources increase. The hypothesis to consider is that the capacity of managers to engage in such extraction has increased.<sup>93</sup> The issue, as the financier John Bogle has recently put it, is whether the United States moved toward an "ownership society" in which managers serve owners or an "agency society" in which managers serve themselves.

A school of thought (prominent in the field of law and economics) sees the United States's and other systems of diffused ownership as representing the best protections for stockholders.<sup>94</sup> That view relies heavily on a principal-agent analysis that sees boards of directors as protecting shareholders through "arm's-length negotiations" with executives. Yet in many cases, boards are not playing the role outlined in this theory. Lucian Bebchuk and Jesse Fried provide many findings more consistent with a "board-capture" view, in which boards are so beholden to managers that they offer



**Figure 6.** The evolution of executive compensation (mean pay of top executives)

Source: Carola Frydman and Raven Saks, "Historical Trends in Executive Compensation, 1936–2003" (Working paper, Massachusetts Institute of Technology, Cambridge, MA, 2005).

Note: Sum of salaries, bonuses, long-term bonus payments, and the Black–Scholes value of stock option grants for the three highest-paid officers in the largest fifty firms in 1940, 1960, and 1990.

little countervailing authority.<sup>95</sup> Perhaps most telling, the design of CEO compensation often varies markedly from what one would expect if it were intended to encourage good performance. Indeed, in much the same way that our view of interest groups suggests opportunities to outflank disorganized "outsiders" (exploiting structural advantages under conditions of asymmetric information), Bebchuk and Fried demonstrate the prominence in corporate arrangements of what they call "camouflage." Patterns of executive compensation seem designed to mitigate public outrage rather than limit excessive pay or link it more closely to value.

Most accounts of American inequality, if they touch on these issues at all, regard them as matters of markets, not politics. At a minimum, however, policy makers (like police officers who studiously look the other way) have done little to constrain the dramatic shift that has taken place. This is in sharp contrast to the experience abroad, where—even though executive pay is much lower—there have been substantial efforts to monitor and impose limits on executive pay, and where sources of countervailing power appear to be much stronger. Again, the comparative evidence of American (or at least Anglo) exceptionalism with regard to executive pay suggests that there is nothing about the structure of modern capitalism that makes such extraordinary increases in executive salaries inevitable or even likely.

In fact, one can see strong links between American policy making and the explosion of executive compensation. The most direct, and consequential, concerns the development of stock options. This constitutes another highly significant example of

policy drift. During the 1990s, stock options became the central vehicle for enhancing executive compensation—indeed, roughly 50 percent of executive compensation came through stock options by 2001. Although ostensibly a vehicle for linking pay to performance, these options were almost always structured in ways that lowered the visibility of high payouts (by removing them from financial accounts at the time they were granted). Moreover, options were granted without creating strong connections between payout and managerial effectiveness, even though instruments for establishing such links were well known and widely used abroad.<sup>96</sup> The value of options simply rose along with stock prices, even if stock price gains were fleeting, or a firm's performance badly trailed that of other companies in the same sector. In the extreme but widespread practice of "backdating," option values were reset retroactively to provide big gains for executives—a practice akin to repositioning the target after the fact to make sure the archer's shot hits the bull's-eye.

To its credit, the Financial Accounting Standards Board (FASB), which oversees accounting practices, recognized the distorted incentives early on. In 1993, it announced plans to require the expensing of stock options. At the time options were issued, firms would be required to estimate the likely costs of this form of compensation. Adopting the practice would have forced firms to acknowledge the true (large) cost of issuing stock options in advance, and would almost certainly have diminished their meteoric rise.

It never happened. Managers, especially in the rapidly growing tech industry, mobilized opposition against the change.<sup>97</sup> Led by Senator Joe Lieberman, Democrat of Connecticut, elected officials moved quickly to block the proposed reform.<sup>98</sup> By overwhelming margins, the Senate passed a resolution expressing its disapproval. Facing clear indications that action could lead elected officials to strip FASB of its authority, the regulators backed off.<sup>99</sup> This is a clear and important example of drift—where organized political action effectively prevents the updating of policy in response to changing market outcomes that were advantageous to the wealthy and powerful.

More broadly, policy making in the recent past has been unfriendly to the general concept of encouraging countervailing powers that might have the resources needed to check and monitor managers' actions (including decisions related to executive pay). In many nations, organized labor has served as a crucial institution that plays this countervailing role, both within firms and as a large shareholder through pension funds. But while American unions have tried to challenge corporate pay prerogatives, their comparative weakness has hampered and distracted them in this effort. Another possible check on managerial autonomy, private litigation, was significantly curtailed in 1995. That was the year in which a bipartisan coalition passed the Private Securities Litigation Reform Act (PSLRA) over President Clinton's veto, "making it much more difficult for shareholders to win lawsuits against corporations or underwriters who deliberately falsified information."<sup>100</sup> Republican Chris Cox, who President Bush would later appoint as head of the SEC, was a major architect of the bill. In 1998, a bipartisan coalition passed important amendments to the PSLRA, requiring all class-action lawsuits for securities fraud to be brought in federal court, making it more difficult to prove breach of fiduciary duty.



Political conflicts over recent efforts to increase board independence and capacity for shareholders to offer an effective check on managers reveal a similar story. After a series of massive scandals involving CEO enrichment that often wiped out the assets of their shareholders and employees, elected officials faced strong pressure to reform structures of U.S. corporate governance in the early 2000s. High levels of public outrage made opposition difficult. Still, analysts suggest that Sarbanes–Oxley would have been blocked had not the collapse of WorldCom as the 2002 elections approached made further obstruction too risky. Even then, policy makers were able to resist the kinds of reforms that comparative analysis suggests would have put the most effective checks on managerial autonomy.<sup>101</sup> Indeed, the nature of the compromise embodied in Sarbanes–Oxley is revealing. Managers accepted efforts designed to modestly increase transparency and regulate some of the most blatant conflicts of interest. At the same time, they quite effectively resisted efforts to increase the capacity of shareholders to influence the governance of firms, including compensation practices.

The structure of American corporate governance—and its associated, distinctive patterns of executive compensation—is a prime contributor to American winner-take-all inequality. To a considerable if largely unrecognized extent this is a *political* outcome. The policy alternative is not just hypothetical; other countries, including ones with market systems relatively similar to the United States, have moved to facilitate organized countervailing powers to managers.<sup>102</sup> Yet in the United States, even after Sarbanes–Oxley, huge differences remain in the relative capacity for organized action of managers and shareholders. And there is substantial evidence that political authorities remain far more attentive to the interests of the former than the latter. Consider former SEC chief Arthur Levitt's telling depiction of the political environment of the mid-1990s—one in which concentrated, highly organized interests wielded extensive power over agendas and policy design, preventing the updating of policy to reflect changing realities:

During my seven and a half years in Washington . . . nothing astonished me more than witnessing the powerful special interest groups in full swing when they thought a proposed rule or a piece of legislation might hurt them, giving nary a thought to how the proposal might help the investing public. With laser-like precision, groups representing Wall Street firms, mutual fund companies, accounting firms, or corporate managers would quickly set about to defeat even minor threats. Individual investors, with no organized labor or trade association to represent their views in Washington, never knew what hit them.<sup>103</sup>

### *Financial Deregulation*

With the pillars of high finance now battered, it is easy to forget how dramatic the rise of the American financial sector has been. Wages and salaries in U.S. financial services roughly doubled their share in the economy over the past three decades, expanding from 5 percent to nearly 10 percent of all wages and salaries between 1975 and 2007. The percentage of the economy composed of financial industry activities

exploded—from less than 2 percent just after World War II to more than 8 percent (Figure 6). Between 1980 and 2007, financial service companies expanded their proportion of company profits from around 13 percent to more than 27 percent. (In the early 2000s, the share nearly reached one-third of all corporate profits—despite the fact that employment in the sector was lower than it was thirty years ago.) Even staid corporate giants got into the act. In 1980, GE earned 92 percent of its profit from manufacturing. In 2007, more than half of GE's profits came from its financial businesses. The home address of the winner-take-all economy has been neither Hollywood nor Silicon Valley, but Wall Street.

The rise of finance is virtually synonymous with the rise of winner-take-all, since in no major sector of the economy are gains so highly (and increasingly) concentrated at the top. In part, this is just a chapter of the broader rise of executive pay. But the other part is the runaway rewards that have flowed into the pockets of the rich out of America's widening range of exotic new financial institutions—from boutique hedge funds to massive financial conglomerates crossing once-inviolable regulatory boundaries. These rewards have involved the development of complex new financial products that, for most Americans, offered limited benefits—and sometimes real economic risks—but which held out the prospect of big returns from every financial transaction and spectacular incomes for those within the industry.

At the very top, the gains were mind-boggling. In 2002 it took \$30 million to make it to the top twenty-five hedge fund incomes; in 2004, \$100 million; in 2005, \$130 million. That year, five hedge fund managers made \$500 million or more. These were just the biggest of the big winners, however: in the two years before they began reporting losses that dwarfed the profits of prior years and brought many of their stockholders to ruin, the venerable firms of Goldman Sachs, Merrill Lynch, Morgan Stanley, Lehman Brothers, and Bear Stearns paid their employees bonuses of \$75 billion. As chronicled in popular accounts from *Bonfire of the Vanities* to *Wall Street*, wages in the financial sector took off in the 1980s. But what were considered princely sums at that time simply set the floor for what was to follow. The pace of the rise actually accelerated in the 1990s, and again after the millennium. Current revelations about Wall Street excesses make abundantly clear that the central chapter in the chronicle of winner-take-all inequality is a tale of American finance.

As with executive compensation, attempts to discuss the political roots of this economic transformation were long dismissed out of hand. Until a few years ago, high finance was depicted as the purest of markets. When analysts referenced the preferences of "Wall Street," it was taken as almost a synonym for economic rationality itself, rather than as a set of specific economic interests. Yet financial markets, like others, are not prepolitical. Our financial system has always rested on an extensive set of government interventions. Public policy establishes the legal environment for financial transactions, including such crucial issues as what constitutes insider dealing or an unacceptable conflict of interest, how much monitoring and transparency there will be in major financial transactions, and what levels of leverage and risk are acceptable given the potentially massive externalities associated with

large-scale speculation. In response to market failures on all these dimensions in the run-up to the Great Depression, extensive new federal regulations were designed during the New Deal to ensure investor confidence and align private ambitions more closely with broad economic goals such as financial stability. Regulations sought to limit conflicts of interest, encourage transparency, and discourage reckless risk taking that placed the desire for private gain in conflict with the integrity and security of the financial system.

Over the last three decades, these relatively quiet and stable financial markets gave way to ones that were both far more dynamic and—for good or ill—had far more pervasive effects on the rest of the economy. Some of this dramatic shift was clearly driven by changes in the nature of economic activity and the possibilities for financial intermediation. Technological innovation made possible the development of new financial instruments and facilitated spectacular experiments with securitization. Moreover, as Robert Gordon and Ian Dew-Becker note, technology helped “shift Wall Street from million-share trading days in the 1980s to billion-share trading days since the late 1990s,” which “must also have contributed to the multi-fold increase in real incomes of investment bankers and share traders.”<sup>104</sup>

Nonetheless, the gradual shredding of the post-New Deal rulebook for financial markets did not simply result from the impersonal forces of “financial innovation.” Titans of finance are wont to airbrush the role of government out of their tales of individual economic success. Sanford Weill, the former chairman of Citigroup, put it this way: “People can look at the last 25 years and say this is an incredibly unique period of time. We didn’t rely on somebody else to build what we built.”<sup>105</sup> But Weill and the other financial chieftains who prospered so greatly during this “unique” period relied a great deal on supportive politicians in government. Weill, for example, helped lead the industry assault on the Glass–Steagall Act, stripping away key conflict-of-interest and transparency rules. These “reforms” legalized powerful financial conglomerates, such as the one produced by Weill’s merger of Travelers Insurance and Citibank to form Citigroup (an entity that would become a ward of the American taxpayer only a decade later).

Weill’s efforts were part of a massive increase in the political leverage of Wall Street. The aptly labeled category “FIRE” (finance, insurance, real estate) has become a huge and rapidly growing part of the lobbying and campaign finance world. According to the Center for Responsive Politics, political action committees and individual employees of the financial services industry have contributed \$2 billion to federal campaigns since 1989. If one looks at the one hundred biggest contributing firms since 1989 the financial sector (finance, insurance, and real estate) totals more than the following sectors combined: energy, health care, defense, and telecoms. Twenty-five of the sixty-five largest business contributors come from the financial sector.<sup>106</sup>

Individuals associated with financial firms are extremely well represented among the big bundlers who now provide the majority of financing for many presidential campaigns. Hedge funds have become increasingly prominent, and increasingly lean Democratic. In the past few years, for example, the financial services industry has “contributed nearly a third of all the campaign money that has flowed to the chairmen

of the House and Senate committees overseeing the [bank] bailout.”<sup>107</sup> No nonpresidential candidate has ever been as successful a fundraiser for the Democratic Party as Charles Schumer, senator from New York. Schumer’s spectacular record in funding the Democratic Senate Campaign Committee (as well as his own campaign war chest) was made possible by his access to Wall Street, which in turn was facilitated by his emergence as a prominent, reliable guardian for the financial industry.<sup>108</sup> Countering this remarkable array of organizational clout on issues related to regulatory finance was, essentially, nothing beyond a scattering of critics inside and outside government.

Assessing the contribution of specific public and private initiatives to the gradual restructuring of financial markets is a matter of considerable controversy. That public action played a vital role, however, is less in doubt. A recent careful historical study by Thomas Philippon and Ariell Reshef, for instance, suggests that regulatory restrictions on banking had been reduced below their pre-New Deal levels by the late 1990s.<sup>109</sup> Deregulation of bank branching (facilitating mergers and acquisitions) occurred gradually. The separation of commercial and investment banking enforced by Glass-Steagall was relaxed in 1987, 1989, and 1997, before finally being repealed by the Gramm-Leach-Bliley Act of 1999. Ceilings on interest rates were deregulated in the early 1980s, especially through the Garn-St. Germain Depository Institutions Act of 1982. Separations between banks and insurance companies required by the Bank Holding Company Act of 1956 were repealed in 1999.

Other political efforts were geared to keeping regulators away from emerging areas of financial activity—a classic form of policy drift. Robert Kuttner has recounted the case of Wendy Gramm, George H. W. Bush’s chair of the Commodity Futures Trading Commission (CFTC). Only a few days before leaving office in early 1993, she “issued a midnight order sought by Enron allowing it to make over-the-counter trades in exotic derivatives of its own creation, exempt from CFTC supervision.”<sup>110</sup> A few weeks later Mrs. Gramm received a seat on Enron’s board. Her husband, Phil Gramm, was an even more prominent performer in the financial deregulation movement. As chair of the Senate Banking Committee, he was instrumental in passing a little-noticed but milestone piece of deregulation, the Commodity Futures Modernization Act, during the lame-duck fall 2000 session of Congress. The 262-page bill was slipped as an amendment into a far larger appropriations bill, and signed into law by President Clinton. It essentially exempted derivatives and other exotic instruments from regulation by the agencies that regulated more conventional financial assets. Gramm was also a constant and effective opponent of those advocating a greater regulatory response to the rapidly evolving financial marketplace. Then SEC chair Levitt, who was one of those advocates, later recounted the ferocity of that opposition. According to Levitt, Gramm offered some pointed and inadvertently prescient advice: “Unless the waters are crimson with the blood of investors, I don’t want you embarking on any regulatory flights of fancy.”<sup>111</sup>

In the crucial 1990s, the pursuit of financial deregulation through both enactments and drift was an all-Washington affair, advancing at both ends of Pennsylvania Avenue and with help from Democrats like Schumer as well as Republicans like Gramm. Many figures in the Clinton administration were as receptive as their Republican predecessors to requests for limited intervention. Treasury Secretary Robert

Rubin was a key actor in gaining administration approval for Gramm–Leach–Bliley. In 1998, Clinton's chair of the CFTC, Brooksley Born, raised the issue of regulating derivatives. Greenspan, Rubin, and Levitt issue a joint statement denouncing her initiative and forcing her to pull back. Rubin even actively sought to curtail CFTC's jurisdiction.

It is no longer controversial to say that high finance profited at the expense of sensible regulations. But Philippon and Reshef have suggested just how intimate the intertwining of rewards and rules has been.<sup>112</sup> For decades after the stock market crash of 1929, their research shows, working in finance was neither all that glamorous nor all that lucrative. Financial jobs were pretty much run-of-the-mill white-collar positions—a dramatic fall from grace for a sector that had once topped the national pay charts. Indeed, the decline in financial pay in the wake of the stock market crash of 1929 tracks almost perfectly the decline in the share of income going to the richest 1 percent during this period, just as the increase in financial pay since the 1980s tracks almost perfectly the post-1970s ascent of the top 1 percent.

It also turns out to track the rise and fall of the regulatory framework that once contained financial excesses. During the New Deal and after World War II, regulations kept finance on a relatively short leash, and the pay of financial professionals in line with white-collar norms. But the wave of financial deregulation since the 1980s fundamentally reversed this trend. Suddenly, and increasingly, financial professionals were earning much more than similarly educated workers. Perhaps as much as half of this expanding financial pay premium, Philippon and Reshef calculate, can be linked to the deregulatory wave of the era.

Policy—both what government has done and what, as a result of drift, it has failed to do—has played an absolutely central role in the rise of winner-take-all economic outcomes. It is not the only thing that has mattered, but it has mattered a lot. Moreover, in the main areas where the role of government appears most significant, we see a consistent pattern: active, persistent, and consequential action on the part of organized interests that stood to gain from a transformation of government's role in the American economy. A winner-take-all politics accompanied, and helped produce a winner-take-all economy.

## Conclusion

Explaining the remarkable rise of winner-take-all requires a true *political economy*—that is, a perspective that sees modern capitalism and modern electoral democracies as deeply interconnected. On the one side, government profoundly influences the economy through an extensive range of policies that shape and reshape markets. On the other side, economic actors—especially when capable of sustained collective action on behalf of shared material interests—have a massive and ongoing impact on how political authority is exercised.

Recent economic accounts have missed the first side of this relationship. Conceptualizing government's role in an excessively narrow way, they have attributed highly

concentrated gains to impersonal technological forces. While this interpretation has some basis, neither the American experience nor comparative evidence suggests it can bear the weight that economists have placed on it.

Recent political accounts have missed the second side of this relationship. Conceptualizing politics and policy in excessively narrow ways, they have sought to sustain an explanatory focus on the median voter. Yet once the hyperconcentration of gains is recognized, and the policy dynamics more clearly outlined, appeals to the median voter look less and less like a plausible line of argument and more and more like a kind of *deus ex machina*.

Perhaps surprisingly, the limits of these accounts flow from a similar source. Too many economists and political scientists have treated the American political economy as an atomized space, and focused their analysis on individual actors, from voters and politicians to workers and consumers. But the American political economy is an *organized* space, with extensive government policies shaping markets, and increasingly powerful groups who favor winner-take-all outcomes playing a critical role in politics. Finding allies in both political parties, organized groups with a long view have successfully pushed new initiatives onto the American political agenda and exploited the opportunities created by American political institutions to transform U.S. public policy—through new enactments and pervasive policy drift. In the process, they have fundamentally reshaped the relative economic standing and absolute well-being of millions of ordinary Americans. Politics and governance have been central to the rise of winner-take-all inequality.

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## Notes

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