MARKETCRAFT
How Governments Make Markets Work

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Markets are institutions embedded in particular laws, regulations, practices, and norms.
Yes, we all know that . . .

Institutional Economics (North, Williamson)
Economic Sociology (Granovetter, Fligstein)
The Régulation School (Boyer)
Comparative Political Economy (Hall & Soskice)
Etc.
But what does it really mean to say that markets are institutions?

It means that markets require governance, not only to protect man and nature from collateral damage, but to function effectively in the first place.
And what does “marketcraft” (market governance) really entail?

Financial regulation
Corporate governance
Labor market regulation
Antitrust enforcement
Sector-specific regulation
Intellectual property rights
Etc.
Today I propose not to describe market governance, but rather to explore the implications of this basic proposition that markets are institutions for policy and analysis.
For if markets are institutions, then . . .

1. There is no such thing as a free market.
2. Markets have to be constructed.
3. Market reform is primarily a constructive enterprise, not a destructive one.
4. Regulation vs. competition is a false dichotomy.
5. Government vs. market is a false dichotomy.
## Market Reform
### Removing Barriers or Building Institutions?

<table>
<thead>
<tr>
<th>Country Type</th>
<th>Removing Barriers (Market-Liberal View)</th>
<th>Building Institutions (Market-Institutional View)</th>
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<tbody>
<tr>
<td>Post-Communist Countries</td>
<td>Shock Therapy “Privatization”</td>
<td>Gradualism <em>Market Transition</em></td>
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<td>Developing Countries</td>
<td>The Washington Consensus “Liberalization”</td>
<td>Building Market Institutions <em>Market Development</em></td>
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<tr>
<td>Industrialized Countries</td>
<td>Neoliberal Reform “Deregulation”</td>
<td>Marketcraft <em>Market Reform</em></td>
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Market Liberalization Versus Market Development

<table>
<thead>
<tr>
<th>More Government</th>
<th>Less Market</th>
<th>More Market</th>
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<tbody>
<tr>
<td>Protection / Regulation</td>
<td>Less Developed Markets</td>
<td>More Developed Markets</td>
</tr>
<tr>
<td>Less Government</td>
<td>“Free Markets”</td>
<td></td>
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</tbody>
</table>
Deregulation versus Reregulation
Government versus Market, or the Governed Market?
Markets as Institutions
Implications for Policy

Think of “marketcraft” as a core government function, roughly comparable to statecraft.

Marketcraft can produce spectacular successes or devastating failures, just like statecraft.
U.S. Cases

The Information Revolution

The Financial Crisis
The Information Revolution

Government R&D funding, early-stage capital, procurement

The Silicon Valley ecosystem

Antitrust policy breaks up value chain

User-driven innovation

Telecommunications reform
The Financial Crisis

The authorities gave financial institutions more freedom to take risks without strengthening regulation

Failed to regulate derivatives

Did not address misaligned incentives in mortgage finance

Put too much faith in market players
Greenspan: Those of us who have looked to the self-interest of lending institutions to protect shareholder’s equity (myself especially) are in a state of shocked disbelief . . .

Chairman [Henry] Waxman: Your statement: “I do have an ideology. My judgment is that free, competitive markets are by far the unrivaled way to organize economies. We have tried regulation, none meaningfully worked.” That was your quote. You had the authority to prevent irresponsible lending practices that led to the subprime mortgage crisis. You were advised to do so by many others. Now, our whole economy is paying its price. Do you feel that your ideology pushed you to make decisions that you wish you had not made? . . .

Greenspan: What I am saying to you is, yes, I found a flaw . . .
## Conceptual Lapses and Policy Failures

<table>
<thead>
<tr>
<th>Conceptual Lapse</th>
<th>Policy Example</th>
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<tbody>
<tr>
<td>Overestimating the ability of market forces to sustain competition</td>
<td>British, U.S., Japanese telecommunications reform</td>
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<tr>
<td>Assuming that regulation constrains markets and freedom</td>
<td>The U.S. net neutrality debate</td>
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<tr>
<td>Favoring caution in antitrust enforcement</td>
<td>U.S. Microsoft and Google cases</td>
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<tr>
<td>Assuming that stronger property rights support innovation</td>
<td>U.S. overextension of patents and copyrights</td>
</tr>
<tr>
<td>Emulating specific policies without viewing market governance holistically</td>
<td>Japanese attempts to emulate Silicon Valley</td>
</tr>
<tr>
<td>Overestimating the benefits of “deregulation”</td>
<td>Japanese market reforms</td>
</tr>
<tr>
<td>Favoring market incentives without attention to their design</td>
<td>U.S. policies favoring stock options</td>
</tr>
<tr>
<td>Failing to view “deregulation” as market design</td>
<td>U.S. electricity markets, especially California</td>
</tr>
</tbody>
</table>
Implications for Scholarship
Examples from Comparative Political Economy

The Varieties of Capitalism
  Boyer summary slide
  Prasad 2012
The U.S. Case

The Varieties of Capitalism (continued)
  Couch & Streeck 1997
  Hall & Soskice 2001

The Japanese Case
Alternative Varieties of Capitalism

Keynesian economic policy

State led

Coordinated economies

Organized systems

Embedded capitalism

Late development

US UK FRANCE JAPAN GERMANY

FRANCE GERMANY UK JAPAN US

GERMANY FRANCE JAPAN US UK

GERMANY JAPAN FRANCE UK US

JAPAN GERMANY FRANCE US UK

Rule based economic regime

Market led

Uncoordinated economies

Disorganized systems

Disembedded capitalism

Early development

Source: Robert Boyer
“The United States had heavier financial regulation because the United States is not a liberal political economy at all, and theories of comparative political economy ignore this at their peril.” (p. 243)
The U.S. "free market" economy is just as heavily governed as a coordinated economy like Japan, possibly more.
The U.S. “Free Market” as the World’s Most Heavily Governed Economy

The United States is at or near the top in the world in regulatory complexity – based on the number of regulatory laws and the number of words in each law – in the various categories evaluated in the Global-Regulation database index.
The Most Heavily Governed Economy

The U.S. Federal Register has 30,194 documents and 78,796 pages (2014).
The U.S. Code of Federal Regulations has 236 volumes with 175,268 pages (2014).
The U.S. Code of Federal Regulations has 1,040,940 “restrictions” as measured by words that indicate an obligation to comply (2012), versus 403,000 in 1970.

Sources: Regulatory Studies Center, GWU; Mercatus Center
“A deregulated international economy subdivided into deregulated national economies would be an institutional monoculture.”
“LMEs will find it difficult to develop non-market coordination of the sort common in CMEs, even when the relevant institutions can be put in place. Because market relations do not demand the same level of common knowledge, however, there is no such constraint on CMEs deregulating to become more like LMEs.”
The Japanese Case

A coordinated economy like Japan requires more governance, not less, to shift toward the liberal market model.
What Would It Take to Turn Japan into a Liberal Market Economy?

The “Free Market” answer:

Just stop intervening in the market.

The Marketcraft answer:

A lot!
<table>
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<tr>
<th>LABOR</th>
<th>REGULATIONS</th>
<th>PRACTICES</th>
<th>NORMS</th>
</tr>
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<tbody>
<tr>
<td>• Labor law reform &lt;br&gt;• Corporate law reform &lt;br&gt;• Pension reform &lt;br&gt;• Lift holding company ban &lt;br&gt;• Strengthen social safety net</td>
<td>• Government upgrades information dissemination and job matching &lt;br&gt;• Courts permit employers more freedom with dismissals</td>
<td>• Lay off workers when necessary &lt;br&gt;• Stop favoring new graduates over mid-career hires &lt;br&gt;• Shift from seniority to merit-based pay &lt;br&gt;• Introduce stock options</td>
<td>• The government should not use regulation to preserve employment &lt;br&gt;• Companies should not preserve employment over profits &lt;br&gt;• Employees should pursue labor market opportunities</td>
</tr>
<tr>
<td>FINANCE</td>
<td>• Financial reform &lt;br&gt;• Corporate law reform &lt;br&gt;• Pension reform &lt;br&gt;• Lift holding company ban</td>
<td>• Financial authorities give financial institutions more leeway with new financial instruments &lt;br&gt;• Financial authorities do not favor domestic financial institutions</td>
<td>• Sell off cross-held shares &lt;br&gt;• Banks make lending decisions and price loans on the basis of risk &lt;br&gt;• Banks stop lending to insolvent firms</td>
</tr>
<tr>
<td>COMPETITION</td>
<td>• Strengthen antitrust &lt;br&gt;• Regulatory reform &lt;br&gt;• Bankruptcy reform &lt;br&gt;• Strengthen social safety net</td>
<td>• Strengthen antitrust enforcement &lt;br&gt;• Upgrade economic analysis of collusion and anti-competitive practices</td>
<td>• Choose business partners on the basis of price, not relationships &lt;br&gt;• Do not cooperate or collude with competitors</td>
</tr>
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</table>
Lessons

Do not conceive of market reform as removing barriers, but rather as building market institutions.

Do not conceive of the US/UK (LME) model as a default, or as a less governed type of market.

Do not conceive of the “free market” as a single equilibrium.

→ It’s all marketcraft!