The DENNY CENTER for
Democratic Capitalism
GEORGETOWN LAW

Evaluating the Quality of Market Competition

ANNUAL REPORT ON THE HEALTH OF DEMOCRATIC CAPITALISM 2023

The Denny Center for Democratic Capitalism at Georgetown Law exists to reconcile the benefits of free market capitalism with the needs and expectations of a democratic society.

THE DENNY CENTER AND ITS MISSION

Established in 2020 by a generous gift from Georgetown Law alumnus James M. Denny (L'60) and charged with a unique vision grounded in life experience, the Denny Center for Democratic Capitalism at Georgetown Law exists to reconcile the benefits of free market capitalism with the values and expectations of a democratic society. To carry out its mission, the Denny Center pursues work in three areas: (1) producing research, beginning with the center's signature Annual Report on the Health of Democratic Capitalism (the "Annual Report"), to analyze the current health of democratic capitalism (i.e., both its economic vitality and its broader contribution to the well-being of citizens, households, and society), (2) convening leading voices from business, government, and societal institutions to discuss the existing tensions and recommend potential paths forward, and (3) creating student experiences to enrich their education, engage them in the center's work, and prepare them for lifelong contributions.

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Executive Summary

CONTEXT

Since the publication of the *Denny Center Inaugural Report on the Health of Democratic Capitalism* in May 2022, public concern over the current state of democratic capitalism has only increased. In February 2023, Martin Wolf of *The Financial Times* published *The Crisis of Democratic Capitalism*, a book in which he argues that democratic capitalism is the best system for human flourishing and yet its well-known versions are currently in need of repair. *The Economist* published "From Strength to Strength: America's Economic Outperformance is a Marvel to Behold" in April 2023 arguing that despite its challenges, the U.S. is holding its own in terms of its share of the world's GDP total. Also in April 2023, David Brooks wrote about "The Power of American Capitalism" in his *New York Times* op-ed column, asserting that the dynamism of America's market economy continues to weather cultural and political storms. In September, thirteen presidential centers issued an unprecedented joint statement calling on all U.S. citizens to strengthen American democracy.

At the same time, in its *"2023 Long-Term Budget Outlook"*, the Congressional Budget Office predicted that key measures of economic health will face headwinds in the years ahead. GDP forecasted growth will slow from its historical annual average growth rate of 3% to 1.5% over the next thirty years. Government spending will raise national debt to a forecasted 181% of GDP over the same time period. In addition, the aging population and declining birth rates will negatively impact the labor force participation rate, leaving labor force productivity as the only real lever to boost GDP growth.

IN REVIEW | THE DENNY CENTER INAUGURAL REPORT

Our Inaugural Report evaluated how well the benefits of free market capitalism are balanced with the needs and expectations of a democratic society. While free market capitalism is highly efficient at generating wealth, reconciling the benefits of capitalism with broader societal needs and aspirations is a perennial tug of war. The Denny Center was founded on the belief that maintaining balance between the two is critical to the future of both capitalism and a flourishing democratic society.

The *Inaugural Report* organized its analysis around five core questions:

1. **Efficacy & vitality:** *Does our economic system generate growing total wealth?*
2. **Fairness & social mobility:** *Does the system address the well-being of all members of society, or does it favor distinct groups?*
3. **Social well-being & stability:** *How does the system strengthen (or weaken) society more broadly?*
4. **Business environment:** *What is the current status and nature of free market competition, and how well is the business community positioned to address current pressures on the system?*
5. **International comparisons:** *How does the U.S. compare to other democratic economies, and what can we learn from the differences?*

By studying objective data and following a clinical approach, we identified a number of areas for further research[1] with almost two-thirds of the topics relating to the ***business environment (Item #4 above)***, *i.e., the nature of free market competition and the readiness of business to address critical system pressures.* This important subset of issues for further research include:

- Decreasing **quality of market competition** and apparent rise of **crony capitalism**
- **Increasing government regulatory budgets** as well as business and lobby spending
- Lack of **value-creating rationales and tangible actions** for corporate boards and management teams that better integrate the needs of all stakeholders in long-term strategy and which do not impair compensation fairness for employees or discourage investment by shareholders
- Additional follow-up issues related to the business environment included excessive levels of **executive compensation,** lack of **stewardship of natural resources,** the absence of industry self-regulation, and apparent **concession by shareholders of the inherent right to vote shares** held by fiduciaries on their behalf

LOOKING AHEAD | DENNY CENTER RESEARCH PROCESS AND 2023 REPORT FOCUS

The Denny Center takes a clinical approach to measuring the health of democratic capitalism, using a data-driven approach to assess how well the market economy is serving the well-being of our democratic society. To that end, our team identified and grouped vital statistics relevant to the health of democratic capitalism in the U.S., recorded U.S. trends for each vital statistic dataset, and compared a subset of these vital statistic results to those of a handful of other developed countries.[2] In this follow-up report, we have grouped the datasets into two sections: (1) **revisiting key datasets from our inaugural report** one year later, and (2) **taking a deep dive into the quality of market competition** with the addition of new datasets as applicable. This year's report also includes responsive essays from economists Betsey Stevenson (University of Michigan) and Michael Strain (American Enterprise Institute), as well as an addendum on industrial policy and related cautions.

2023 FINDINGS AND QUESTIONS

1. Revisiting Key Datasets One Year Later

Perhaps not surprisingly, given the macro nature of the areas studied, few if any of the data trends show material differences in 2023. Below we summarize our key observations from this year's update:

- The **GDP growth rate is still under pressure,** driven by slowing productivity improvements and lower fertility rates.
- **Labor's share of GDP remains low** by historical standards, and middle-class workers' income appears to be stuck in neutral.
- CEO pay has leveled off somewhat, but depending on how non-cash compensation is quantified, **the ratio of CEO compensation to that of the average worker still exceeds 250-350 times.**
- According to the Gini Coefficient, **income gaps continue to widen,** though new analysis suggests that the income for the lower quintiles of earners might have grown faster than previously believed when all government programs and transfers are properly considered.[3]

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1 See Attachment A for the initial findings of our 2022 Inaugural Report.

2 Australia, France, Germany, Japan and the United Kingdom.

3 See Early, John, Ekelund, Robert, and Gramm, Phil. *The Myth of American Inequality: How Government Biases Policy Debate,* Rowman & Littlefield, 2022.

- **Life expectancy has flattened out** (or decreased for certain portions of the U.S. population), and **the percent of those living in poverty shows little, if any, improvement.**
- According to Edelman's updated survey, **trust in institutions has remained at historic lows**—with trust in business only slightly better than that in government. Other surveys indicate Americans only really trust small business and the military.[4]
- **Expenditures in response to billion-dollar disasters** remain at historically high levels, driven largely by extreme-weather events.
- On the international comparison front, **the U.S. has not gained much, if any ground, relative to other democratic economies.**

2. Deep Dive: Vital Signs Measuring the Quality of Market Competition

Overall, the datasets we studied point to increasing headwinds that threaten the quality of market competition. In addition, the consequences that result from a lower quality of market competition decrease society's confidence in the market economy.

Our initial findings from the deep dive on the quality of market competition include:

- **Overall industry concentration has increased** over historical norms, and in most of the industry sectors we studied, overall profits are up, and the **market share of the largest competitors has grown.**
- **Lower GDP growth continues and could be driven in part by the consequences of less robust market competition** including lower investment, less innovation, and the reduced variety of consumer choices in certain sectors.
- Though government antitrust actions fluctuate with political administrations, there appears to be **a downward longer-term trend in antitrust enforcement.**
- **Net investment has stayed constant or declined,** as companies continue to pay out more in dividends and share repurchases.
- **Government regulation, as measured by pages in the federal register, continues to rise** and lobbying spending shows no signs of slowing down.
- Labor impacts include stagnant wages, and **lower productivity may indicate a lack of worker motivation** and confidence in their employers.
- The **public's views related to capitalism and the market economy are growing more negative**—and are likely contributing to the declining trust in institutions overall and to a growing pessimism about the United States' standing in the world.
- **Government agency accountability and performance are also in question,** leaving citizens with little hope for innovative responses to constructively address shortcomings of the market economy.

KEY QUESTIONS FOR PATHS FORWARD

- How can we monitor the quality of market competition on an ongoing basis, and what criteria should we use to decide when actions (private and/or public) are needed?
- Because market concentration can be profitable for owners and investors over the long-term, what can

4 See recent surveys by Gallup, the Pew Research Center, and Wake Forest University's Center for the Study of Capitalism.

be done outside of government regulation to motivate businesses to address the negative impacts on other stakeholders?

- Should corporate boards and management teams factor the health of the broader market economy into their long-term strategies? And if yes, how?
- What level of government intervention is appropriate to support healthy market competition without overreaching—and potentially stifling business investment, risk taking, and innovation?
- How much of a role does less robust market competition play in lower GDP growth vis-à-vis other forces including fertility rates and worker productivity?
- Is it possible to give citizens more agency in addressing the health of the market economy? What role(s) might cultural institutions reclaim to help in this regard?

Revisiting Key Datasets One Year Later

In this section of the report, we updated a handful of key datasets from our 2022 Inaugural Report; the selected datasets are listed below and shown on the following pages.

1. **Efficacy & Vitality:** *Does our economic system generate growing total wealth?*
   - Gross domestic product
   - Output per hour
   - Total factor productivity
   - Fertility rates

2. **Fairness & Social Mobility:** *Does the system address the well-being of all members of society, or does it favor distinct groups?*
   - Labor compensation share
   - Real household income
   - CEO pay versus that of the average worker
   - Income inequality as measured by the Gini coefficient

3. **Social Well-Being & Stability:** *How does the system strengthen (or weaken) society more broadly?*
   - Life expectancy
   - Population living in poverty
   - Trust in institutions
   - Billion-dollar disasters

4. **Business Environment:** *What is the current status and nature of free market competition, and how well is the business community positioned to address current pressures on the system?*

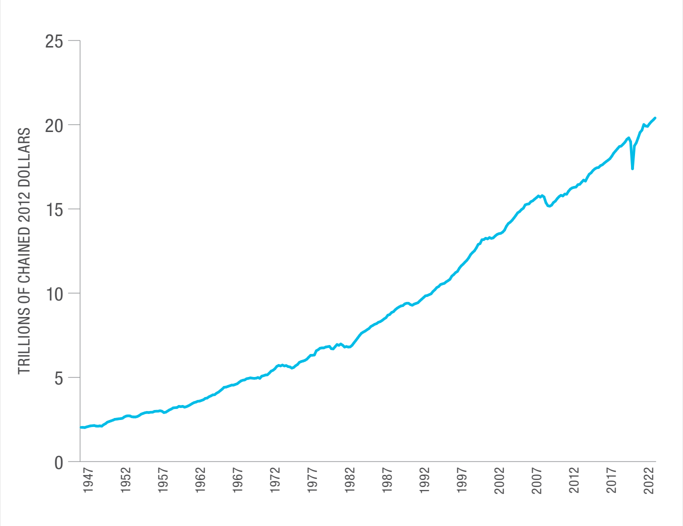
   (See Deep Dive Section)

5. **International Comparisons:** *How does the U.S. compare to other democratic societies, and what can we learn from the differences?*
   - GDP growth
   - Social spending per capita
   - Income inequality
   - Life expectancy

1. EFFICACY & VITALITY

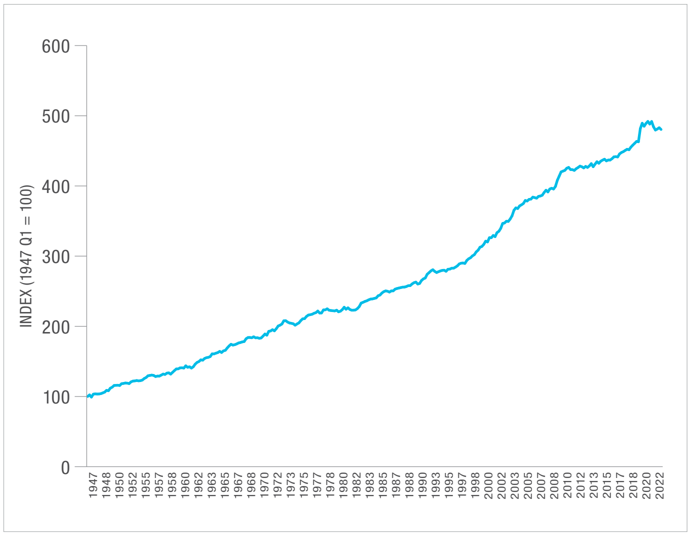
Does our economic system generate growing total wealth?

Real GDP Growth in Chained 2012 Dollars,[5] 1947-2023



Source: U.S. Bureau of Economic Analysis, Real Gross Domestic Product [GDPC1], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/GDPC1, accessed July 28, 2023.

Real Output Per Hour in the Nonfarm Business Sector, 1947-2022



Source: Federal Reserve Economic Data, https://fred.stlouisfed.org. OPHNFB from FRED "Labor Productivity (Output per Hour) for All Employed Persons", accessed July 25, 2023.

Our economic system continues to generate a growing amount of total wealth over time, including a strong bounce-back after the 2020-21 COVID-19 contraction. Inflation-adjusted gross domestic product—"real GDP"—measures the quantity of goods and services produced in the nation. Real GDP is equal to the level of domestic production purchased by consumers, businesses, and the government, as well as production exported to other nations. While raw economic output may leave out many factors that matter to a citizen's well-being (e.g., leisure time, health status, or political freedom), GDP does provide a good measure of the resources available to a society, and the growth rate of that output can help describe increases in living standards.

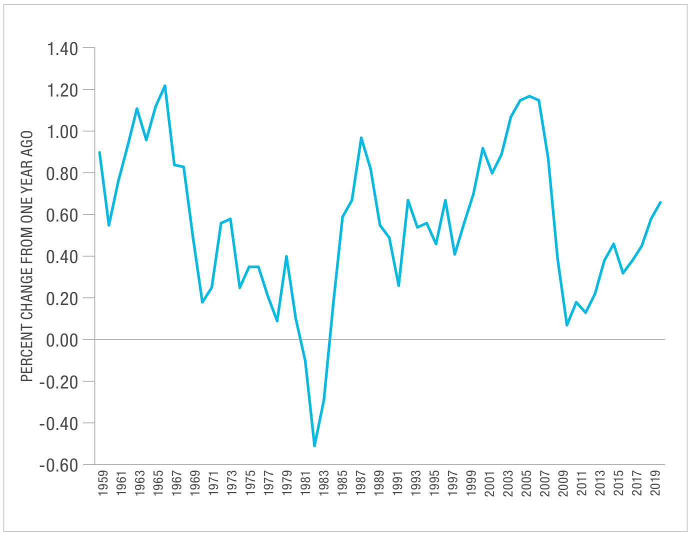
Real GDP increases when the number of workers in the economy increases or when those workers become more productive. Since our Inaugural Report in May 2022, we have seen continued growth in real GDP in line with pre-pandemic expectations. However, compared to previous decades, real GDP has grown more slowly in recent years (excluding the 2020-21 bounce back period), partly due to slower population growth and an aging population. In addition, the growth in workforce productivity has slowed over the last fifteen years. If these trends continue, the U.S. will not get poorer, but living standards will rise less rapidly.

For the economy to grow, either the size of the workforce needs to grow or workers need to become more productive. Productivity is defined as a worker's output per hour, meaning that to produce greater productivity and economic growth, workers must increase the amount of economic output produced for every hour worked. Productivity can increase dramatically when new technologies allow workers to produce more, and can grow over long horizons as the labor force becomes better educated.

Over long time horizons, productivity growth is crucial to increasing living standards. After many centuries, the first substantial increase in living standards occurred due to new technologies invented during the Industrial Revolution. In the U.S., productivity increased during the 1990s when businesses figured out how to use modern computers to increase output. However, the rate of productivity growth has slowed in recent years.

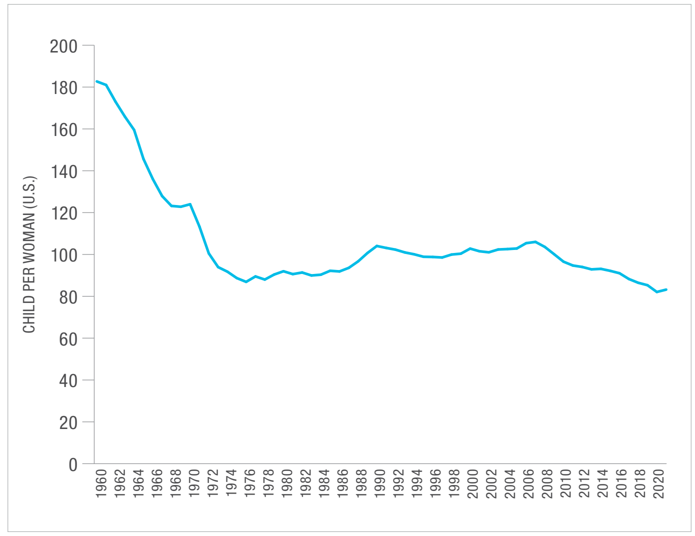
[5] Chained dollars is a method for adjusting real dollar amounts for inflation over time to allow the comparison of figures for different years; it generally reflects the dollar amounts computed with 2012 as the base year.

Five Year Moving Avg of Annual Change in Total Factor Productivity, 1959-2019



Source: University of Groningen and University of California, Davis, Total Factor Productivity at Constant National Prices for United States [RTFPNAUSA632NRUG], retrieved from FRED, Federal series/RTFPNAUSA632NRUG, accessed September 14, 2021. Author's calculations.

Fertility Rates, 1950-2021



Source: St. Louis Federal Reserve, https://fred.stlouisfed.org/series/SPDYNTFRTINUSA, accessed 28 July 2023.

In addition to the productivity of the labor force, total factor productivity captures the share of increases in economic output not accounted for by increases in the inputs to production, including labor and capital. It measures the rate at which technology is improving and the extent to which businesses are making efficient use of inputs to production. Like labor productivity, this measure shows substantial growth in the early 1960s and 1990s, with slowing growth after the Great Recession in 2008.

The total fertility rate is defined as simply the number of children per woman,[6] and it has roughly decreased by half since 1950. This decrease is attributed to a significant increase in access to education by women, the increase in workforce participation by women, decreasing child mortality rates, and the rising cost of bringing up children. Because fertility rates affect the size of the future workforce, this decline could indicate long-term reductions in the growth rate or an eventual drop in GDP. The economic effects of declining fertility rates could be offset by longevity, technological innovation, immigration, and/or social policies to encourage higher birth rates by supporting young families.[7] However, this would require targeted government intervention or innovation that is not guaranteed to be effective even if it does occur.

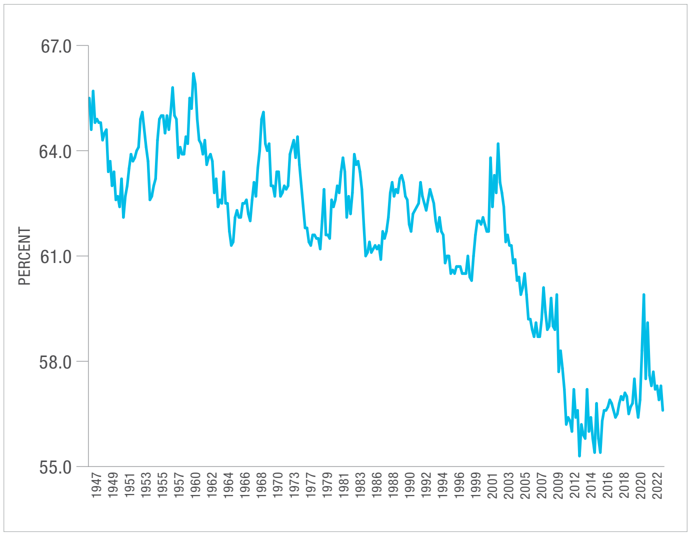
[6] More precisely it is the average number of children that would be born to a woman over her lifetime if 1) the woman were to experience the exact *current* age-specific fertility rates through her reproductive years and 2) the woman were to survive from birth through the end of her reproductive life (most institutions define this age bracket as 15-49 years).

[7] On a positive note, according to a United Nations Department of Economic and Social Affairs policy brief, France has seen some success with supporting high fertility rates through public spending on families. Their efforts are made up of a range of policies including targeted tax benefits, generous parental leave, a family allowance program, subsidized child care, as well as means-tested benefits, social assistance and housing subsidies for low income families.

2. FAIRNESS & SOCIAL MOBILITY

Does the system address the well-being of all members of society, or does it favor distinct groups?

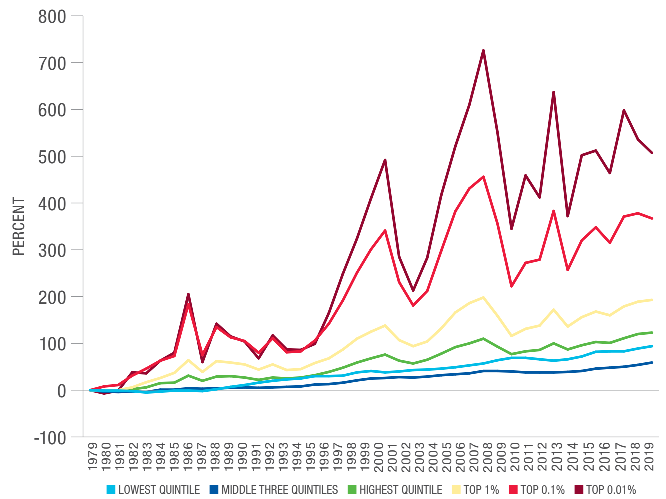
Labor Compensation as a Share of GDP, 1947-2023



Source: BLS Major Sector Productivity data. www.bls.gov/news.release/prod2.nr0.htm, accessed July 25, 2023.

This graph shows the share of total economic output that is paid as compensation to workers and can be compared to the share of output returned to owners of capital. Labor's share of income can fluctuate widely, but on average has declined since half a century ago. This trend makes it more difficult for standards of living to increase for the majority of workers.

Cumulative Growth in Real HH Income After Taxes and Transfers, 1979-2019



New Source: Congressional Budget Office, 2022. "The Distribution of Household Income, 2019," Report 58353, Congressional Budget Office. Published November 15, 2022, accessed July 25, 2023.

Average Earned Household Income By Quintile, 2017 (Dollars)

	MARKET INCOME AFTER TAXES & TRANSFERS (CENSUS)	MARKET INCOME AFTER TAXES & TRANSFERS (ALTERNATE ANALYSIS)
BOTTOM	$14,725	$49,613
SECOND	$39,239	$53,924
MIDDLE	$67,808	$65,631
FOURTH	$109,442	$88,132
TOP	$245,198	$197,034
TOP-TO-BOTTOM RATIO	**16.7**	**4.0**

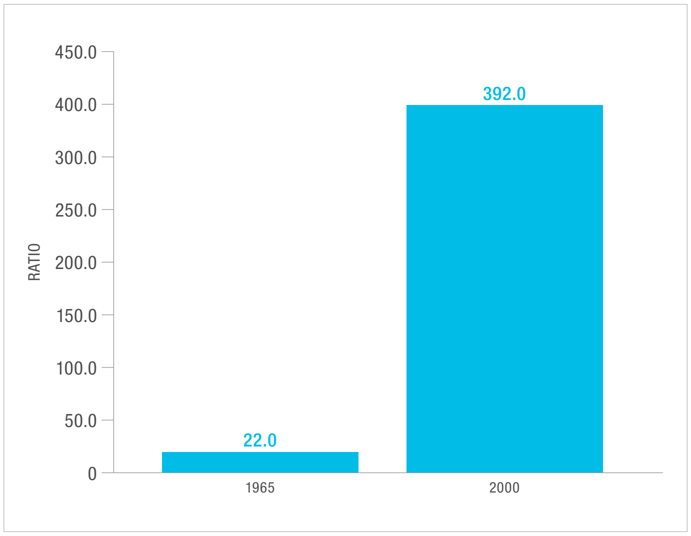
Sources: Semega, Jessica and Kollar, Melissa. "Income in the United States: 2021", U.S. Census Current Population Reports (September 2022), p. 31, accessed 10 September 2023; Gramm, Phil et al., *The Myth of American Inequality*, Rowan & Littlefield, 2022, p. 29.

Based on the U.S. Census methodology for measuring market income, income for middle-class households has not stagnated over the past four decades, but it has grown substantially more slowly than income at the top. The top 20% of the income distribution has seen three times as much growth as the middle 60%. Additionally, greater income gains are correlated to higher income. The top 0.01% has seen cumulative income growth of over 400% over the past four decades.

However, recently published analysis points out that the U.S. Census does not include the majority of federal, state, and local government transfer payments (that increase income in the lower quintiles) or taxes (that decrease income in the higher quintiles) in its income calculations. When all transfer payments and taxes are accounted for, new research claims that income inequality has not risen by 22.9% since 1947 as the U.S. Census data shows, but has actually decreased by 3%.[8] The recent analysis does not fully answer the question of why market incomes before transfers and taxes have widened significantly, but it does paint a different picture of actual income differences over time.

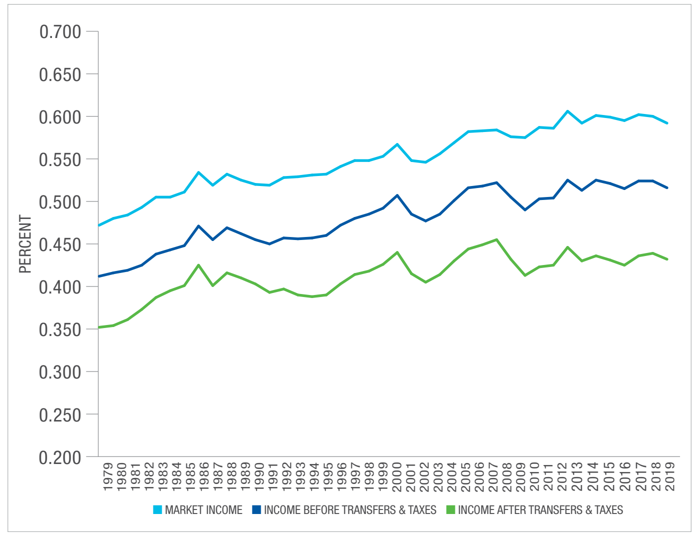
[8] Early, John, Ekelund, Robert, and Gramm, Phil. *The Myth of American Inequality: How Government Biases Policy Debate,* Rowman & Littlefield, 2022, pp. 3-4. The authors concede that not all of the additional transfers are paid as cash payments to recipients; thus, it's fair to perhaps apply a discount rate to the additional transfers. The economic reality for those in the lower income quintiles is likely somewhere in between the Census estimates and the Gramm et al estimates.

Ratio of CEO to Average Worker Compensation, 1965 and 2020



Source: Economic Policy Institute, https://www.epi.org/publication/ceo-pay-in-2021/, accessed July 27, 2023.

Income Inequality as Measured by the Gini Coefficient, 1979-2019



Source: Congressional Budget Office, 2022. "The Distribution of Household Income, 2019," Report 57061, Congressional Budget Office. Published November 15, 2022, accessed July 28, 2023.

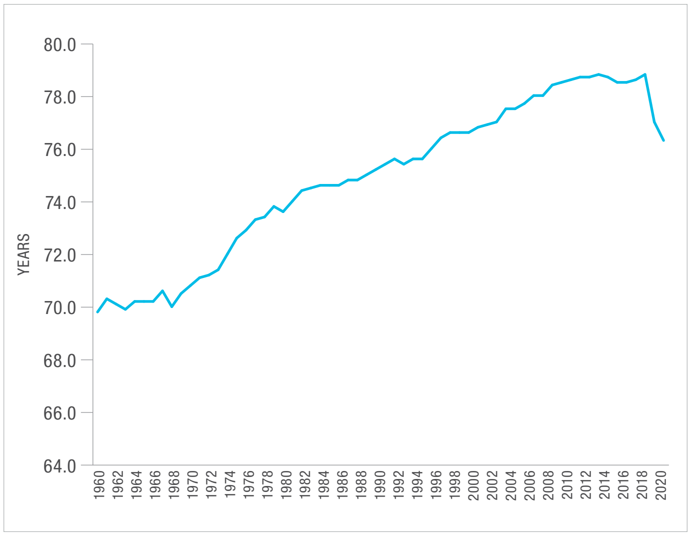
Average annual compensation for CEOs at the top 350 U.S. firms ranked by sales is measured in two ways. Both include salary, bonus, and long-term incentive payouts, but the "granted" measure includes the value of stock options and stock awards when they were granted, whereas the "realized" measure captures the value of stock-related components that accrues after options or stock awards are granted by including "stock options exercised" and "vested stock awards". The ratios shown here use the "realized" measure of CEO compensation.

The tax and transfer system is successful at reducing—but certainly not eliminating—income inequality. As measured by the Gini coefficient—a commonly used measure of inequality, for which a value of 0 implies perfect equality and a value of 1 implies maximal inequality—the tax and transfer system reduces income inequality by around 25%. After rising rapidly from the late 1970s through the 1990s, inequality growth has slowed. By this measure, since the 2008 financial crisis, post-tax-and-transfer income inequality has declined. It should not come as a surprise that the 2022 Gramm et al. analysis suggests a lower Gini coefficient than the official reading based on the Census data; the updated estimate indicates an approximate 30% reduction in the coefficient.

3. SOCIAL WELL-BEING & STABILITY

How does the system strengthen (or weaken) society more broadly?

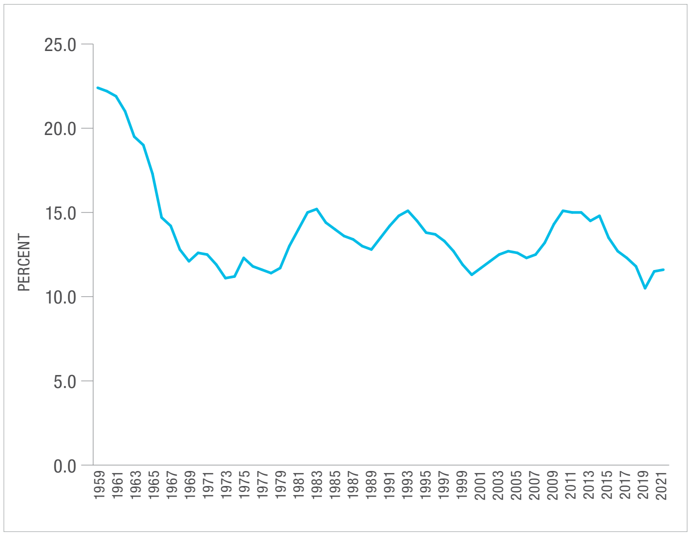
Life Expectancy at Birth, 1960-2020



Source: World Bank, Life Expectancy at Birth, Total for the United States [SPDYNLE00INUSA], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/SPDYNLE00INUSA, accessed July 25, 2023.

Average life expectancy at birth has largely increased since 1960 from roughly 70 years to 78 years but has fallen slightly since 2014. Reductions in infectious disease deaths, infant mortality, and heart attack death rates helped boost life expectancy over time. More recently, declining life expectancy at the bottom of the income distribution has helped halt progress. There are wide gaps in life expectancy across income, race, and geography in the U.S.

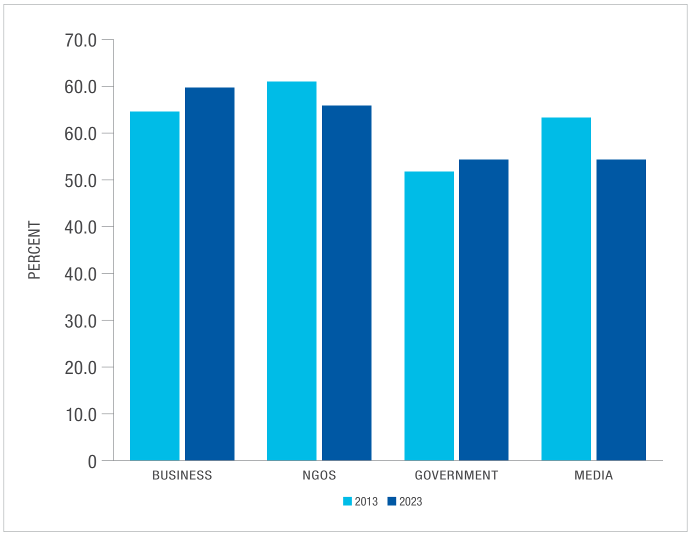
Percent of U.S. Population Living in Poverty, 1959-2021



Source: U.S. Census Report "Poverty in the United States: 2021", published September 13, 2022, accessed July 28, 2023.

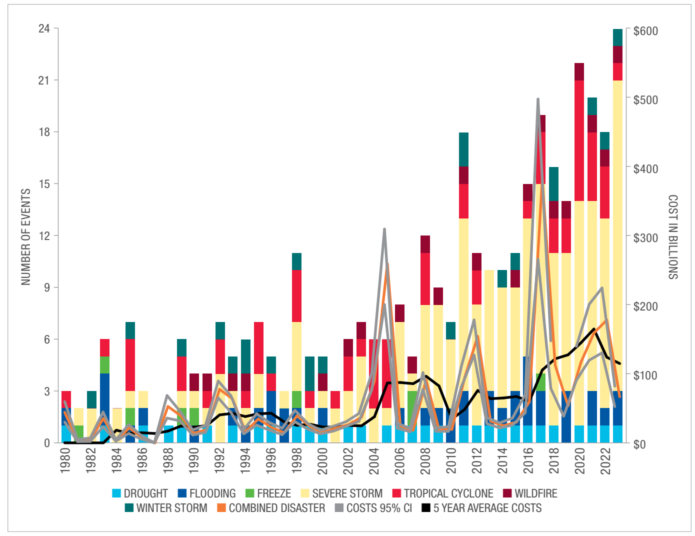
The official poverty measure estimates how many people are unable to afford basic needs using income and the average national cost of food adjusted for inflation. The supplemental poverty measure extends the official poverty measure by taking account of many of the government programs designed to assist low-income families and individuals that are not included in the official poverty measure. Both rates rose during the Great Recession and then trended down through the 2010s. While the official measure rose during the pandemic, taking into account government programs, poverty fell despite unemployment rates spiking to nearly 15% as the aggressive fiscal response to the pandemic expanded government support.

Trust in Institutions, 2013 versus 2023



Source: Edelman Trust Barometer Global Report, 2013 and 2023; https://www.edelman.com/trust/2023/trust-barometer, accessed July 31, 2023.

U.S. Billion Dollar Disaster Events



Source: National Oceanic and Atmospheric Administration, https://www.ncei.noaa.gov/access/billions/time-series, accessed 30 September 2023.

For the last 23 years, Edelman has conducted an annual trust survey to gauge the public's trust in societal institutions (i.e., business, government, NGOs, media) and institutional leaders. In the most recent addition, the firm surveyed more than 36,000 respondents in 28 different countries asking, "for each [institution], please indicate how much you trust that institution to do what is right." Those that received scores from 60-100 are deemed trustworthy, those from 50-59 are neutral, and those from 1-49 are considered to be distrusted. Currently, business is the only institution to barely hang on to a trustworthy ranking, while the rest are seen as neither trusted or distrusted.

Along with the number and intensity of disaster events, the cost of disasters is also increasing. In addition to the direct costs of damages and emergency management spending, disaster events can have secondary economic effects including disruption to work, lost productivity, and disruption to supply chains and essential infrastructure. Though the costs of transitioning towards cleaner energy is often discussed, free-market capitalism should also consider the costs of maintaining the status quo. The costs of continued environmental degradation and the effects of climate change have concrete impacts for society, long-term business interests, and the lives of every American.

4. BUSINESS ENVIRONMENT

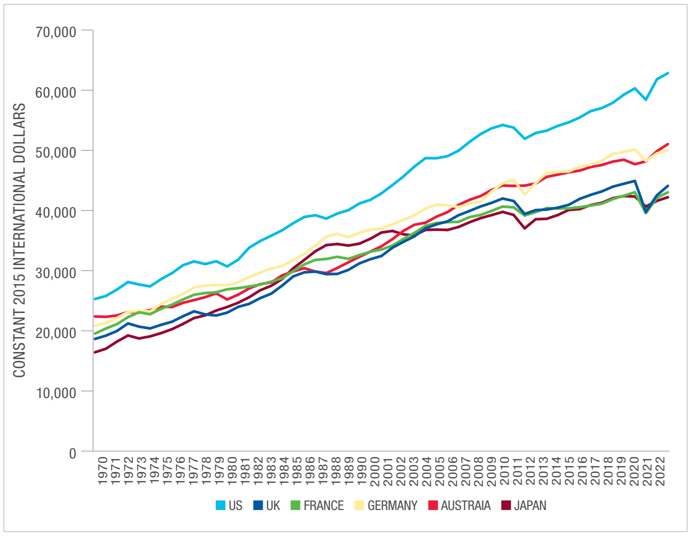
What is the current status and nature of free market competition, and how well is the business community positioned to address current pressures on the system?

5. INTERNATIONAL COMPARISONS

How does the U.S. compare to other democratic societies, and what can we learn from the differences?

See Deep Dive on Quality of Market Competition for Updated and New Datasets

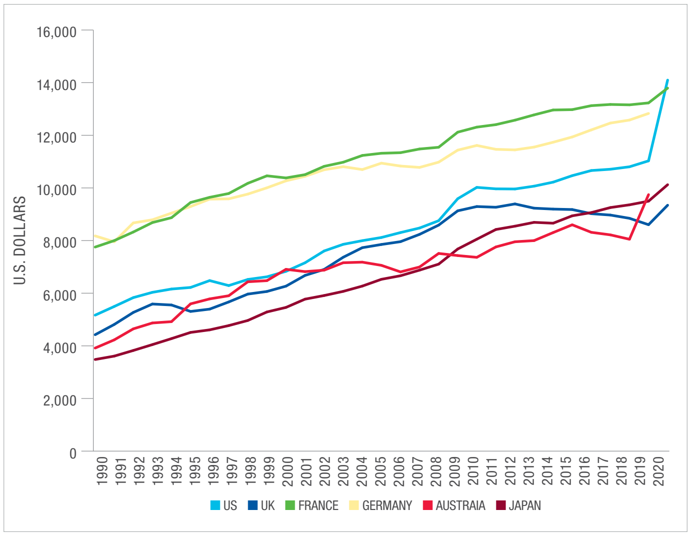
Cumulative GDP Growth, 1970-2022



Source: OECD (2021), "GDP per capita and productivity levels", OECD Productivity Statistics (database), https://doi.org/10.1787/data-00686-en, accessed on July 28, 2023.

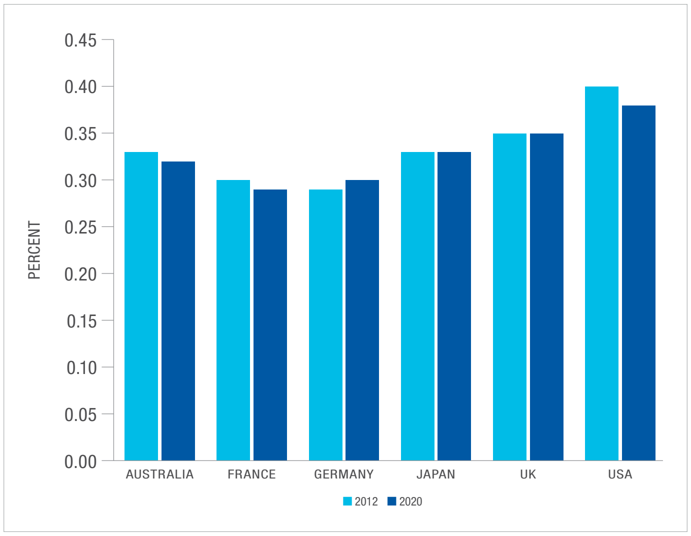
One core fact when comparing the U.S. economy to many of its large advanced economy peers is that the U.S. has a higher level of output per capita. This figure shows the level of GDP per capita for the U.S. and 5 other nations from 1970 to the present. The data are shown in constant prices (adjusting for inflation) and in international dollars (adjusting for exchange rates and price differences across countries) to try to show an apples to apples comparison of GDP per person. Growth rates over time have been reasonably similar, with all 6 economies growing between 100 and 160% over this period, with the U.S. maintaining its lead in output per capita throughout. Output per capita is a function of the share of the population working, the number of hours worked per worker, and the productivity of labor (output per hour).

Government Social Spending per Capita, 1990-2020



Source: OECD, https://data.oecd.org/socialexp/social-spending.htm.

Gini Coefficients After Taxes and Transfers, 2012 Versus 2020

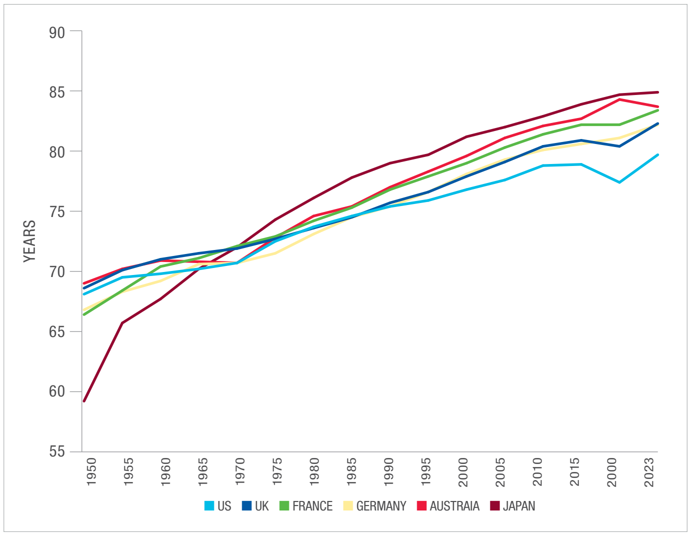


Source: OECD (2023), Income Inequality (indicator), https://data.oecd.org/inequality/income-inequality.htm, accessed 26 July 2023.

Social expenditure comprises cash benefits, direct in-kind provision of goods and services, and tax breaks with social purposes. Benefits may be targeted at low-income households, the elderly, disabled, sick, unemployed, or young persons. To be considered "social," programs must involve either redistribution of resources across households or compulsory participation. Social benefits are classified as public when the government (that is central, state, and local governments, including social security funds) controls the relevant financial flows. All social benefits not provided by the government are considered private. Private transfers between households are not considered as "social" and not included here. The notable upticks in this measure in 2020 are primarily due to pandemic-related spending and are not likely to continue longer-term.

This figure plots average inequality for market income and gross income after taxes and transfers measured using the Gini coefficient in 5-year bins for 6 OECD countries. Average inequality measured using market income has increased in the U.S., France, Germany, and Japan and stayed mostly flat in Australia and the U.K. The level of inequality was fairly similar across these countries (except Australia) in the 2015-19 period. However, adjustments for tax and transfer systems brought the level of inequality down far more in other peer nations than it did in the U.S., such that post-tax and transfer inequality is notably higher in the U.S. using official Census data, especially compared to Germany and France.

Life Expectancy at Birth, 1950-2023



Source: World Bank World Development Indicators, accessed via Worldometers on 07 September 2023.

Since the 1980s, the U.S. has lost considerable ground on life expectancy compared to the selected peer nations. Australia and France have gained nearly 5 years of life expectancy in the last 45 years. Research has found a large and growing gap in life expectancy based on income in the U.S., with essentially no gains in life expectancy from 2001-2014 for the lowest income Americans.

Deep Dive: Vital Signs Measuring the Quality of Market Competition

Competition is an essential ingredient of the market economy, and the quality of competition is a key indicator of the health of a market economy. For consumers, competition among firms promotes innovation, supports a larger variety of products and services, and keeps prices in check. For workers, competition supports higher wages, improved productivity, and better working conditions. For society more broadly, healthy competition instills a sense of equal opportunity and an optimism about future standards of living.

In this deep dive, we attempt to evaluate the current quality of competition by gathering fact-based vital signs in four categories:

BROAD MEASURES
What do overall indicators say about the current quality of market competition?

BUSINESS BEHAVIORS
What measurable actions taken by businesses can lead to—or result from—a lower quality of competition?

LABOR EFFECTS
What do worker-related measures tell us about the current nature of market competition?

SOCIETAL IMPACT
Are there broader society-wide indicators that highlight the quality of competition?

The datasets confirm that overall industry concentration is increasing, and the market share of the largest companies continues to grow. Corporate profits are growing, labor compensation as a percent of GDP is at historic lows, and net business investment is mostly stagnant. Lobbying spending and government regulation show no signs of slowing down; however, despite recent headlines, the data suggests a long-term downward trend in antitrust enforcement. The GDP growth rate is low by historical standards and is projected to remain low for the foreseeable future. At the same time, the public's trust in institutions is declining, and optimism about key elements of the American experiment is waning.

These observations do not offer a precise diagnosis of the quality of market competition, but they do point to real problems and a decreasing confidence in the institutions and leaders historically trusted to address them. Our objective with this report is to challenge readers to consider what we can do to make a positive difference, given our current spheres of influence.

"Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or order of men."

Adam Smith, *The Wealth of Nations* (1776)

"The role of competition is a feature of the free market that we have encountered time and again. A worker is protected from his employer by the existence of other employers for whom he can go to work. An employer is protected from exploitation by his employees by the existence of other workers whom he can hire. The consumer is protected from exploitation by a given seller by the existence of other sellers from whom he can buy."

Milton Friedman, Rose Friedman, *Free To Choose* (1980)

"Markets fail under various circumstances: when firms have monopolistic power which restricts competition; when there are information asymmetries between producers and consumers; when there are 'externalities' or impacts on third parties which are not properly reflected in market prices; and where public and common goods exist whose benefits cannot be captured by individual producers or consumers."

Michael Jacobs & Mariana Mazzucato, *Rethinking Capitalism* (2016)

"The capitalist economic system [. . .] relies on competition. At its best, competition keeps companies honest, narrows costs, expands the job base, sows innovation, distributes the fruits of productivity widely, and gives every member of society a chance to use their talents to earn a living. Competition protects economies, affords possibility, and allows democracy to flourish, as no one firm becomes big enough to control the corridors of power."

David Dayen, *Monopolized* (2020)

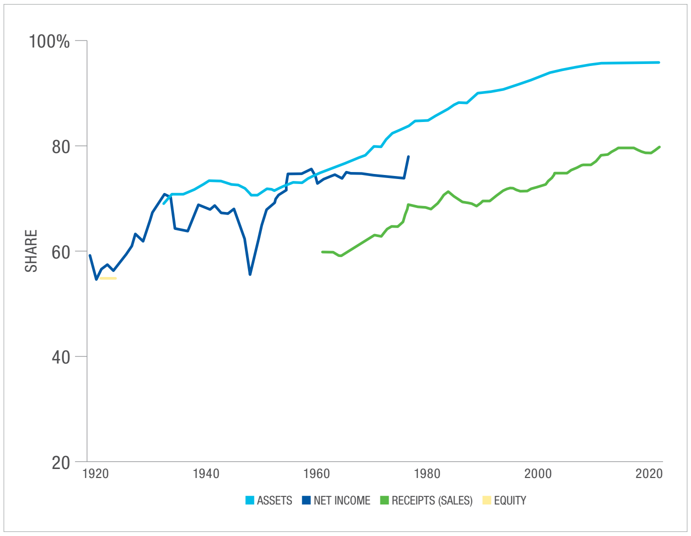
1. BROAD MEASURES

What do overall indicators say about the current quality of market competition?

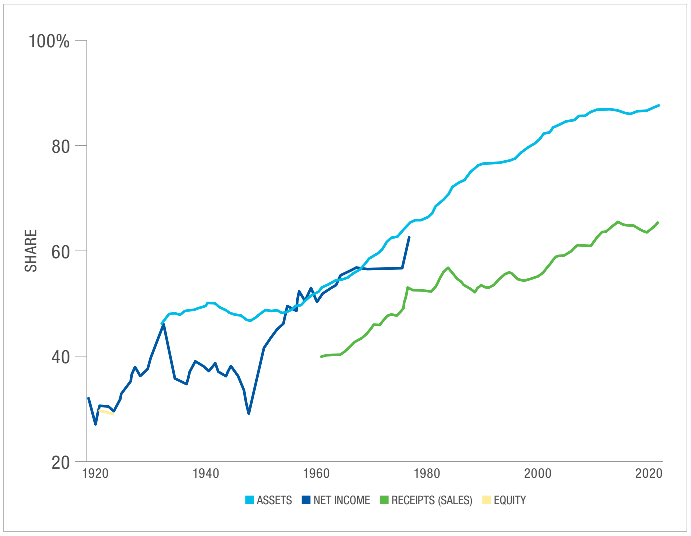
Taken together, these broad measures display at least four trends: (1) concentration is increasing, (2) the annual GDP growth rate is declining, (3) profits are increasing as are prices for consumers, and (4) antitrust actions related to mergers and acquisitions have declined. The datasets do show an increase in market share for the top firms, but also indicate a widespread increase in concentration across most sectors of the U.S. economy. Additionally, though some have asserted that globalization and international competition may be responsible for increased market concentration, the increase in profits pushes back against that theory. For some individual sectors that are greatly exposed to foreign competitors and that have seen profits decline, it is still feasible that globalization might be a more important contributor to concentration.[9]

Overall Business Sector Concentration, 1920-2020

Shares of Top 1% Corporations



Shares of Top 0.1% Corporations



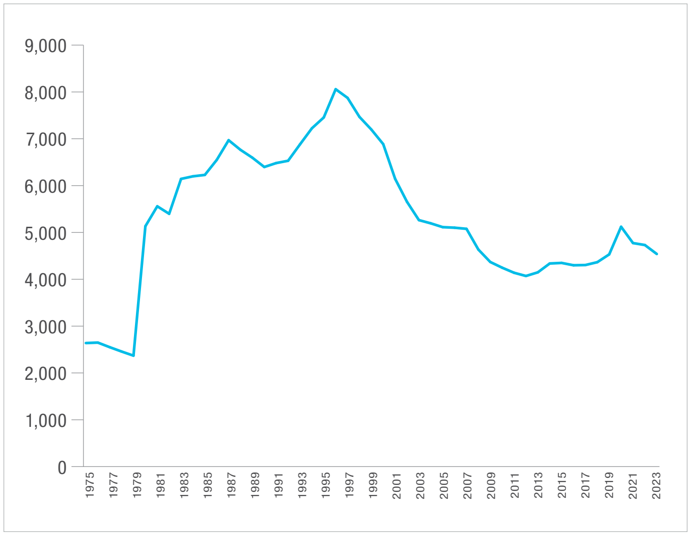
Source: Kwan, Spencer; Ma, Yueran; and Zimmerman, Kaspar, "100 Years of Rising Corporate Concentration", Working Paper No. 2023-20, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4362319, accessed 12 September 2023.

In February 2023, researchers at the University of Chicago's Becker Friedman Institute published a working paper focused on market concentration statistics over the last 100 years. They found that corporate concentration has increased persistently over the time period (either asset share or sales share of top businesses). In addition, they concluded that rising concentration in an industry coincided with increased technological intensity and higher fixed investment.[10]

[9] Philippon, Thomas. *The Great Reversal: How America Gave Up on Free Markets*, Harvard University Press, 2019, p. 57.

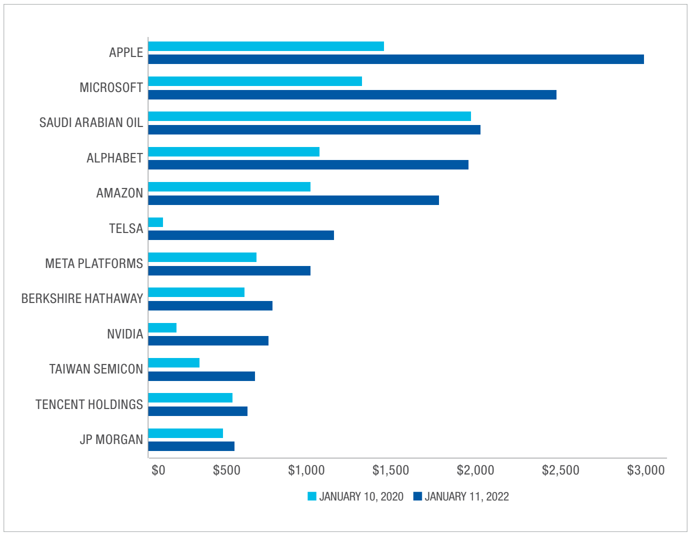
[10] Kwan, Spencer; Ma, Yueran; and Zimmerman, Kaspar, "100 Years of Rising Corporate Concentration", Working Paper No. 2023-20, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4362319, accessed 12 September 2023.

Number of Publicly Listed Companies, 1975-2023



Source: https://www.statista.com/statistics/1277216/nyse-nasdaq-comparison-number-listed-companies/; accessed July 25, 2023.

Market Value of 12 Most Valuable Companies, 2020 Versus 2022



Source: Wolf, Martin. *The Crisis of Democratic Capitalism*, Penguin Press, 2023, p 159.

Since a peak of over 8,000 publicly listed companies in 1996, the U.S. has seen a drop by almost 50% to approximately 4,500 public companies by 2023. This trend could be seen as a threat to the dynamism needed to fuel appropriate levels of competition, future growth, and innovation. However, recent analysis by McKinsey cautions that the decline might not be as consequential as it appears. They demonstrate that the drop-off in listings can be attributed primarily to three sectors (banking, industrials, and technology); the drops occurred primarily because of exits between 2001-2010; and 95% of the exits were the result of acquisitions (not company failures).[11] This doesn't negate the fact that business sectors are more concentrated, but it does confirm that firm exits are not driven by weaker firms being run out of business.

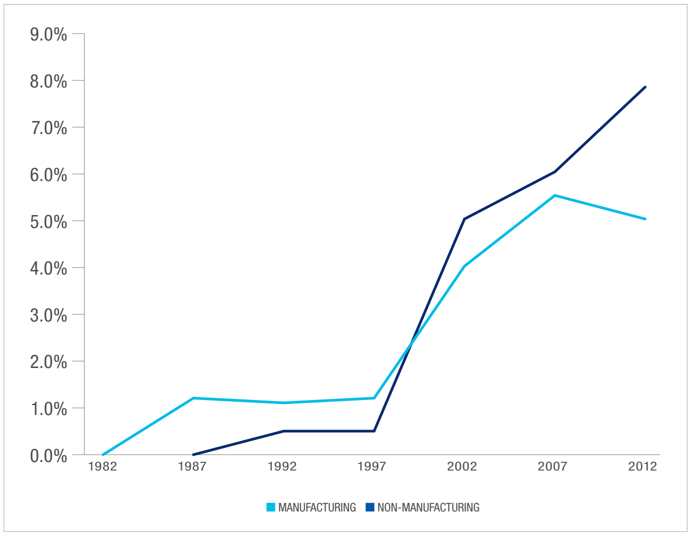
In his recent book, *The Crisis of Democratic Capitalism*, *Financial Times* journalist Martin Wolf highlights the growing problem of industry concentration in certain industry sectors, namely tech and big data. To support his point, he tracks the market value of the 12 most valuable companies in January 2022 versus January 2020. According to Wolf, the drivers of what he calls "winner-take-all markets" include economies of scale and scope, network effects (both direct and indirect), big data and machine learning, brand loyalties, the high cost of switching, the attraction of specific employers to talented workers, the reputation of founders, and the straight-forward economics of agglomeration.[12] It is important to note that these factors cannot entirely explain the longer trend in concentration over time, especially as broader economic factors like economies of scale and network effects existed prior to the emergence of the digital economy. There is little evidence of an increase in returns to scale from 1988-2016 or that intangible assets (patents, market research, marketing, etc.) are more likely than tangible ones to create network effects or other tangible externalities.[13]

[11] McKinsey & Company, "Reports of Corporates' Demise Has Been Greatly Exaggerated," October 2021.

[12] Wolf, Martin, *The Crisis of Democratic Capitalism*, Penguin Press, 2023, pp. 159-160.

[13] Philippon, p. 268.

Cumulative Market Share Growth of Top 8 Firms, 1982-2012



Source: Phillipon, Thomas. *The Great Reversal*, Harvard University Press, 2019, p. 47.

Market Share of Largest 2 Companies by Sector, Early 2000s-2018

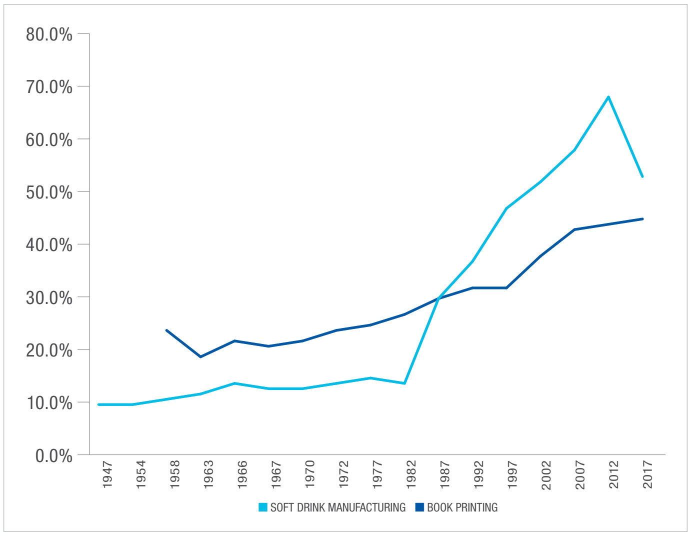
Source: The New York Times, "The Monopolization of America", November 25, 2018, https://www.nytimes.com/2018/11/25/opinion/monopolies-in-the-us.html, accessed 28 July 2023.

The U.S. Census tracks the market shares of the largest companies over time from the top 4 companies to the top 50 companies by industry sector. This chart shows the cumulative growth of the markets shares of the top 8 companies for manufacturing and for nonmanufacturing sectors. The chart originally appeared in economist Thomas Phillipon's 2019 book, *The Great Reversal*. Though the growth of market share concentration somewhat stalled in the late 1980s and 1990s, it has growth 4-8% by 2012.

The *New York Times* recently documented the growth of the 2 largest companies by industry sector over a period of 15 years, demonstrating that in most sectors the dominant companies market share continued to strengthen over time. From movie theaters and railroads to airlines and pharmacies, industries saw the top two companies' markets shares rise significantly. Drawing from data compiled by The Open Markets Institute, the Times documents market shares of the top 2 companies ranging from 35-40% for credit cards and movie theaters on the lower end to over 80% for hardware stores and tobacco manufacturing.[14]

[14] Leonhardt, David. "The Monopolization of America." *The New York Times,* 26 Nov. 2018, www.nytimes.com/2018/11/25/opinion/monopolies-in-the-us.html.

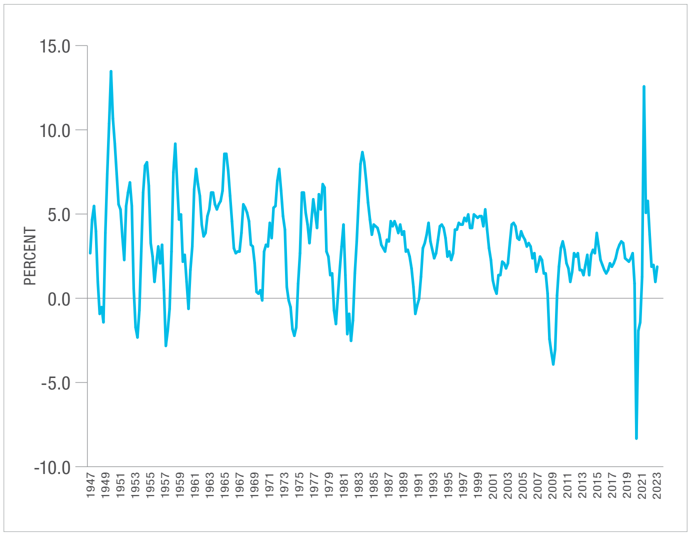
Example Market Shares of Top 4 Firms, 1940s/1950s-2017



Source: Economic Census, U.S. Census Bureau, https://www.census.gov/programs-surveys/economic-census.html, accessed 26 July 2023.

In its annual Economic Census, the U.S. Census Bureau estimates the market shares of the various numbers of leading companies. We show here the combined market share for the Top 4 firms in Soft Drink Manufacturing and Book Printing as examples, beginning the 1940s or 1950s, respectively, and running through 2017. As shown, the market shares of the Top 4 firms grew from 10-20% to near 50% by 2017. These examples only build on the Philippon data to demonstrate increasing concentration is factually true in many industry sectors.

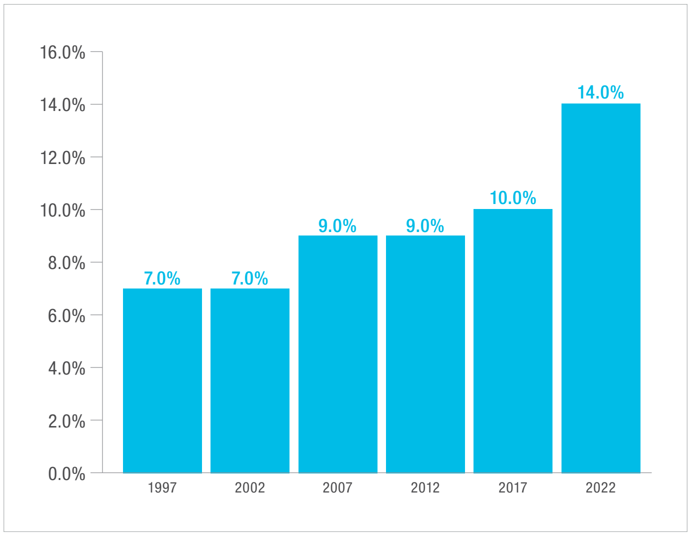
Real GDP Growth Rate Over the Previous Four Quarters, 1948-2022



Source: U.S. Bureau of Economic Analysis, Real Gross Domestic Product [GDPC1], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/GDPC1, accessed 28 July 2023.

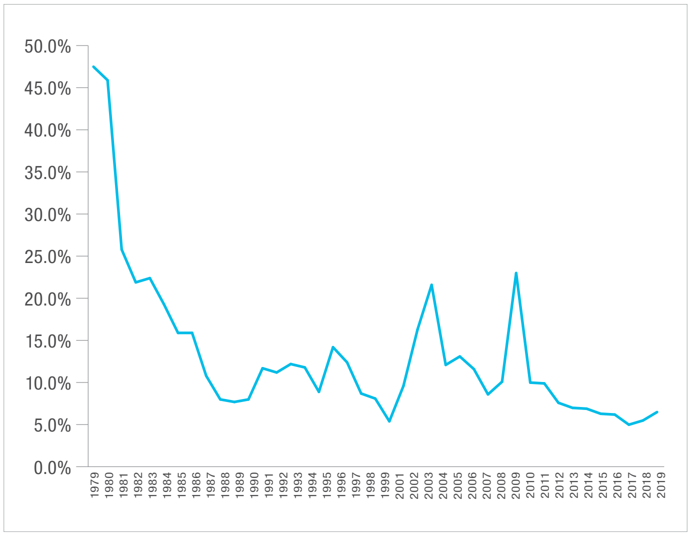
Though total real GDP continues to grow, the rate of real GDP growth has slowed down. The rate at which GDP grows is a crucial measure of economic performance and social well-being. This measure shifts sharply, turning negative during recessions when the economy is shrinking, and then rebounding into positive territory when the economy is growing. The drop in 2009 and then especially 2020 were particularly sharp in historical context. Compared to previous decades, real GDP has grown more slowly in recent years (excluding the 2020-21 bounce back period), partly due to slower population growth and an aging population. In addition, the growth in workforce productivity has slowed over the last fifteen years. If these trends continue, the U.S. will not get poorer, but living standards will rise less rapidly.

S&P500 Earnings as Percent of Revenue, 1997-2022



Source: S&P Corporation, IBES datasets.

Antitrust Investigations as Percent of Filings, 1979-2019



Source: U.S. Department of Justice Antitrust Division, Workload Statistics, https://www.justice.gov/atr/division-operations, accessed July 26, 2023.

The operating income of the S&P500 set of companies has grown since the late 1990s from approximately 7% to 14% as measured as a percent of reported revenue. While increased profits do not alone prove a lower quality of market competition, when combined with other indicators, they raise a real possibility that profits on average are higher because competition is less robust.

Another way to evaluate industry concentration is by tracking antitrust activity (or lack thereof) by the government agencies that monitor proposed corporate merger and acquisition activity. The U.S. Department of Justice tracks its workload in a number of ways, including the number of merger and/or acquisitions proposed by companies via Hart-Scott-Rodino (HSR) filings; it also tracks the resulting number of antitrust investigations it pursues. The data presented here shows the number of antitrust investigations as a percentage of HSR filings, falling from as high as 25% in the early 1980s to just 5-7% in recent years. This is not a perfect indicator of a lack of market competition, but it does indicate a significant drop off in the close evaluation of merger and acquisition activity over the last 40 years.[15]

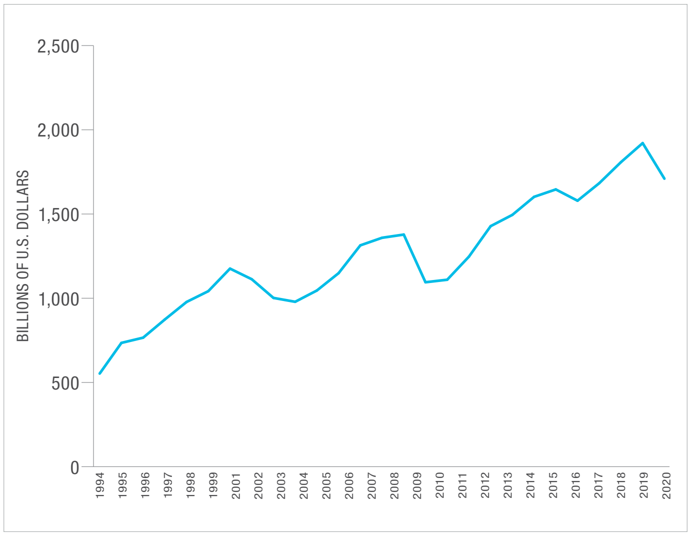
[15] U.S. Department of Justice Antitrust Division, Public Documents on Division Operations, https://www.justice.gov/atr/division-operations.

2. BUSINESS BEHAVIORS

What measurable actions taken by businesses can lead to—or result from—a lower quality of competition?

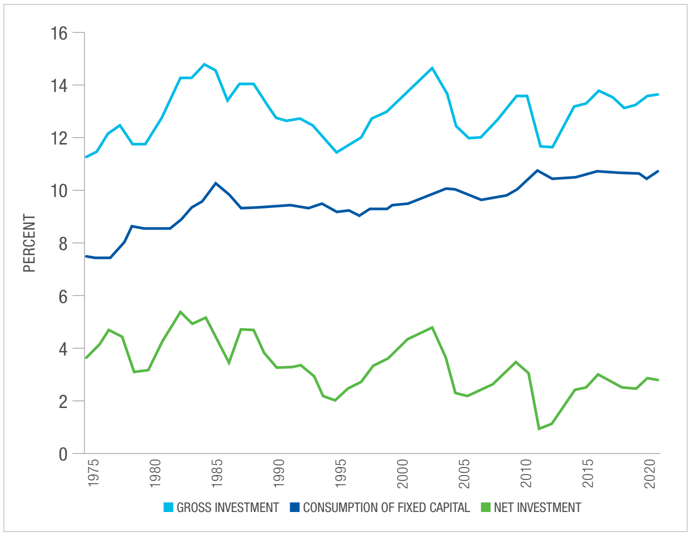
These indicators demonstrate several trends about business behaviors and innovation throughout a period of concentration. Investment is decreasing. In contrast, R&D spending (both private and public) has increased over time, though it makes up a diminishing portion of government spending. The number of patents is increasing though it is unclear whether this indicates growing innovation or just firms seeking to patent a wider range of ideas. Both the number of total regulations and lobbying spending are increasing which may point to growing incidence of regulatory capture.

Annual Business Capital Expenditures, 1994-2020



Source: U.S. Census Capital Spending Reports (2012, 2022) and ACES tables, https://www.census.gov/library/publications/2021/econ/2021-csr.html, accessed July 27. 2023.

Net Business Investment, 1970-2020



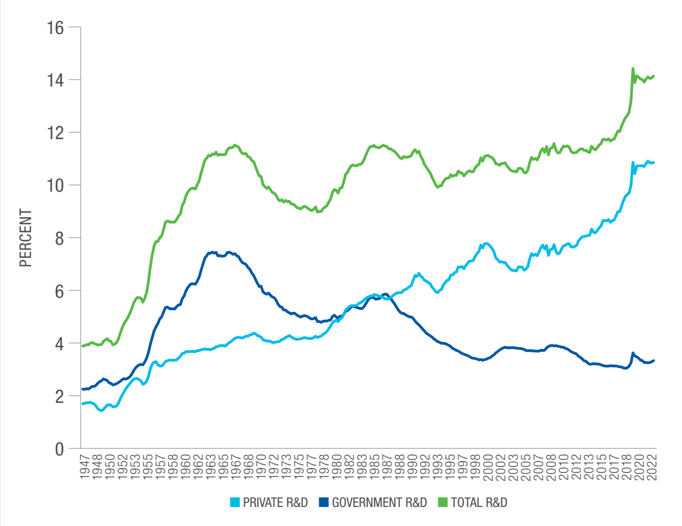
Source: "The Rise of Wall Street and the Fall of American Investment", American Compass, 2021, https://americancompass.org/speculating-wall-street-investment/, accessed 12 September 2023.

The U.S. Census Bureau tracks total capital expenditures for businesses, and for the past 25 years the total is slowly but steadily increasing. However, when taken as a percentage of GDP, business capital expenditures have been relatively steady, according to analysis by TheGlobalEconomy.com. Financial theory holds that companies will invest in new capital projects or acquisitions if the projected return on investment exceeds their cost of capital, but in practice, business leaders know that projected returns are just that, "projected". As industries grow more concentrated, and the largest firms feel less threatened by fewer or weaker competitors, capital investment may shrink as there's less of an incentive to take risks and innovate.

American Compass recently released research demonstrating that net private investment (gross investment less annual consumption of fixed capital) is decreasing as firms consume more of investments already in place than they replace via new investment annually. Researchers found that over time, company fund flows back to investors are greater than those going into new investment opportunities (and requiring new market funding), and the number of companies that are depleting their fixed investments and paying more in share repurchases and dividends than they earn in net income is growing significantly. As research suggests that successful firms have historically maintained high levels of investment,[16] this may have concerning implications for the long-term health of democratic capitalism though it is also possible that the decline in investments reflects the age and size of firms rather than a decline in innovation.

[16] Philippon, p. 72.

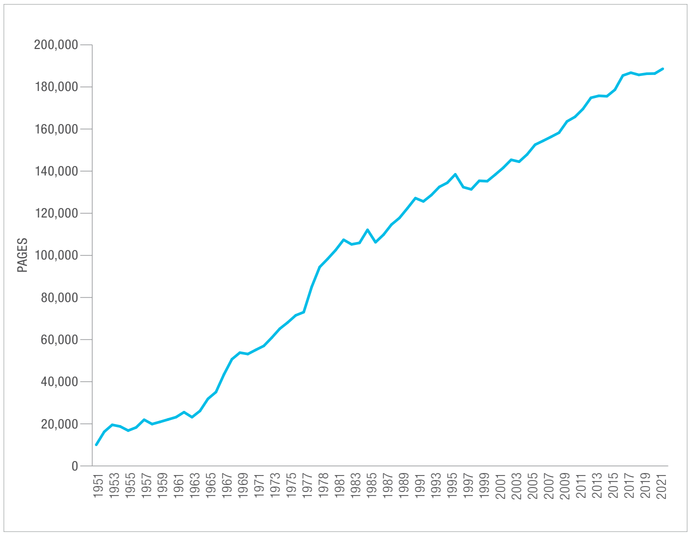
Government and Private R&D Spending as Share of GDP, 1947-2022



Source: U.S. Bureau of Economic Analysis, Gross Domestic Product: Research and Development [Y694RC1Q027SBEA], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/Y694RC1Q027SBEA, accessed 26 July 2023.

Technological innovation has the greatest potential to advance living standards by increasing the productivity of the workforce and improving quality of life. Investments in basic research lead to transformative, breakthrough innovations. This figure plots private and government spending on research and development (R&D) as a share of total output. Government spending on research and development increased rapidly at the onset of the Cold War and peaked in the mid-1960s. Research and development spending by private companies has steadily increased throughout this period. This steady increase in R&D spending, driven by the private sector, supports the conclusion that innovation is an important characteristic of democratic capitalism.

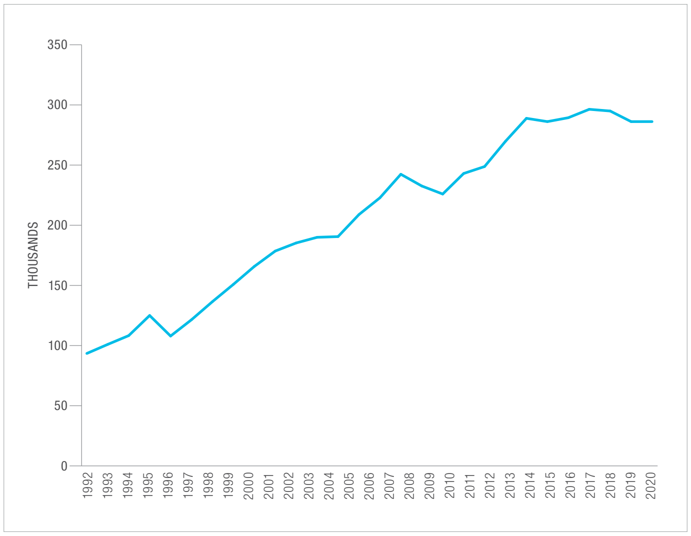
Industry Regulation as Measured by Pages Published in the Code of Federal Regulations, 1950-2021



Source: Regulatory Studies Center, George Washington University, https://regulatorystudies.columbian.gwu.edu/reg-stats, accessed July 26, 2023.

The Code of Federal Regulations (CFR) is the codification of the general and permanent rules promulgated by the departments and agencies of the federal government. The number of total pages published in the CFR annually provides a sense of the volume of existing regulations with which American businesses, workers, consumers, and other regulated entities must comply. According to the Regulatory Studies Center at George Washington University, the number of pages published in the CFR grew from 9,800 pages in 1950 to 188,000 pages in 2021.

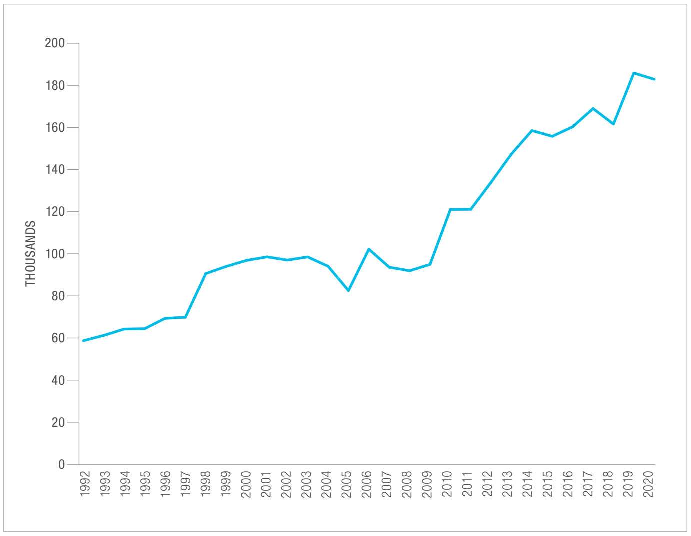
Number of U.S. Patent Applications, 1992-2019



Source: U.S. Patent and Trademark Office, https://www.uspto.gov/web/offices/ac/ido/oeip/taf/us_stat.htm, accessed July 26, 2023.

One indicator of the level of innovation is the number of patent applications in any given year. Since 1992, the number of applications has risen from less than 100,000 to almost 300,000 in 2016. Over the last four years of available data, patent applications have leveled off or slightly declined—possibly indicating a slowdown in innovation.

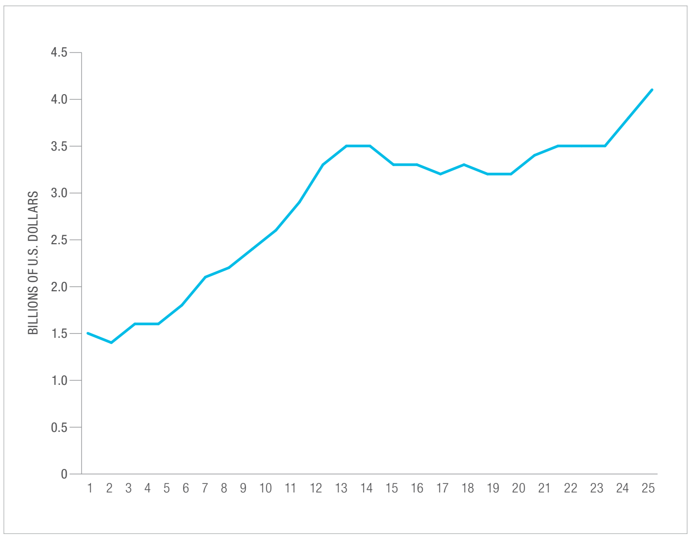
Patents Originating in the U.S. Annually, 1992-2020



Source: U.S. Patent and Trademark Office, U.S. Granted Patents: Total Patents Originating in the United States [PATENTUSALLTOTAL], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/PATENTUSALLTOTAL, accessed July 24, 2023.

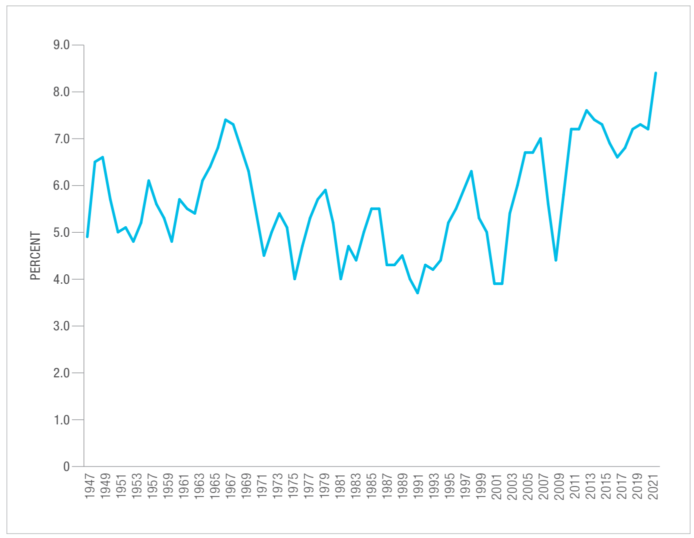
Another measure of the scale of innovation is the number of patents granted per year. A greater amount of new intellectual property rights granted to investors signifies more innovation taking place. This figure plots the total number of patents where the first named inventor resides in the U.S. Total patents are the sum of utility, plant, design, and reissue patents granted by the U.S. Patent and Trademark Office. The number of patents granted has roughly doubled since the Great Recession in 2009. While this may signal increased innovative activity, it may also reflect the patenting of a growing range of ideas (e.g. business practices) or increased low-quality patents (that do not change activity much). Still, the long-term trend points to the system's ongoing innovation.

Lobby Spending in the U.S., 1998-2022



Source: http://statista.com, http://opensecrets.org.

Corporate Profits After Tax as Share of Gross Domestic Income, 1947-2020



Source: U.S. Bureau of Economic Analysis, Shares of gross domestic income: Corporate profits with inventory valuation and capital consumption adjustments, domestic industries: Profits after tax with inventory valuation and capital consumption adjustments

Since the turn of the millennium, lobbying spending in the U.S. has more than doubled. The intention of firms employing lobbyists, who in turn lobby government officials, is to gain a degree of influence on the legislative process in the hope of legislation more favorable to their business or cause being passed. Lobbying occurs at all levels from local government to presidential elections. The industries utilizing lobbying as a means to gain influence come from a range of industries with the biggest spenders including pharmaceuticals, insurance, business associations as well as oil and gas. Additionally, the top firms by industry tend to account for an outsized percentage of lobbying spending, meaning that dominant firms may have an even greater political influence than they do economically.[17]

According to the U.S. Bureau of Economic Analysis, corporate profits after tax have risen as a percent of gross domestic income over the last 70 years, from 5% to over 8% in the most recent year recorded. One likely result of decreasing competition is higher profits, and this indicator joins several others in raising the likelihood of less rigorous market competition.

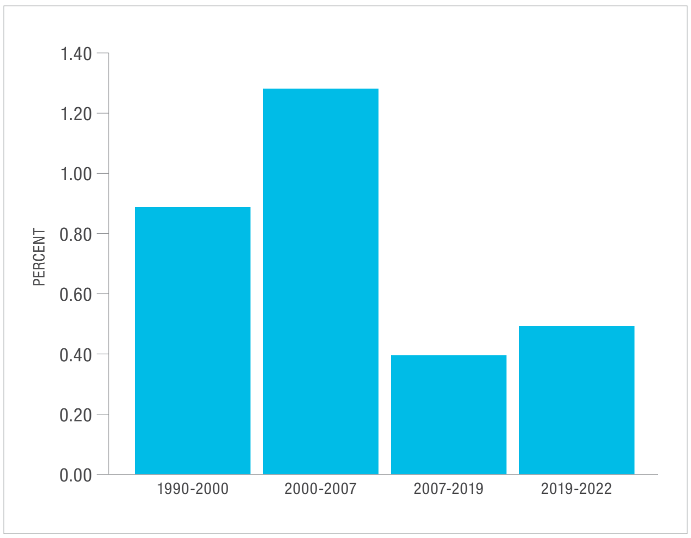
[17] Philippon, p. 168.

3. LABOR EFFECTS

What do worker-related measures tell us about the current nature of market competition?

In addition to giving us insight into the overall health of the economic system, indicators related to labor effects also demonstrate how economic trends impact the average American. The labor effect statistics indicate that productivity, national income, and household income have been increasing over time. However, the rate of income growth for the middle class and the labor's share of overall GDP have stagnated and declined respectively. The U.S. economy has produced positive results recently yet concerns remain about future prospects. Last but not least, labor compensation as a share of GDP is at historic lows; recent actions by a number of unions is another indicator that the labor side of economic equation is feeling pressure.

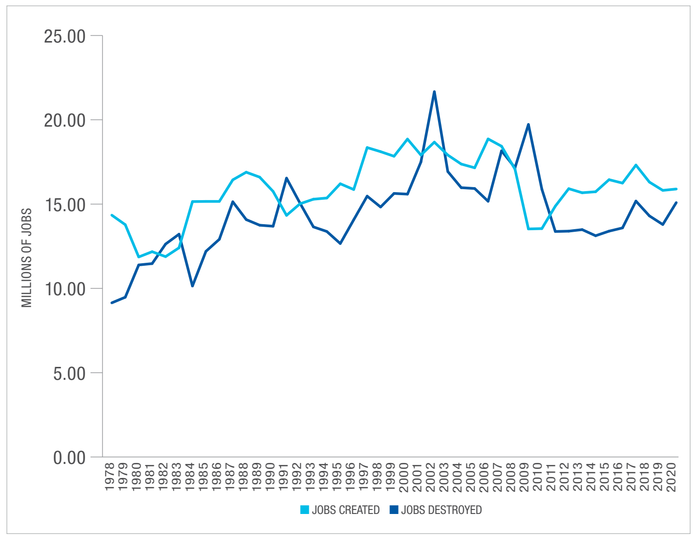
Average Annual Change in Total Factor Productivity, 1990-2022



Source: U.S. Bureau of Labor Statistics, Economic News Release, March 2023, https://www.bls.gov/news.release/prod3.ta.htm, accessed 12 September 2023.

In addition to the productivity of the labor force, a conceptually distinct measure of total factor productivity captures the share of increases in economic output not accounted for by increases in the inputs to production, including labor and capital. It measures the rate at which technology is improving and the extent to which businesses are making efficient use of inputs to production. This measure shows higher growth in the early 1990s and 2000s, with slowing growth after the Great Recession in 2008.

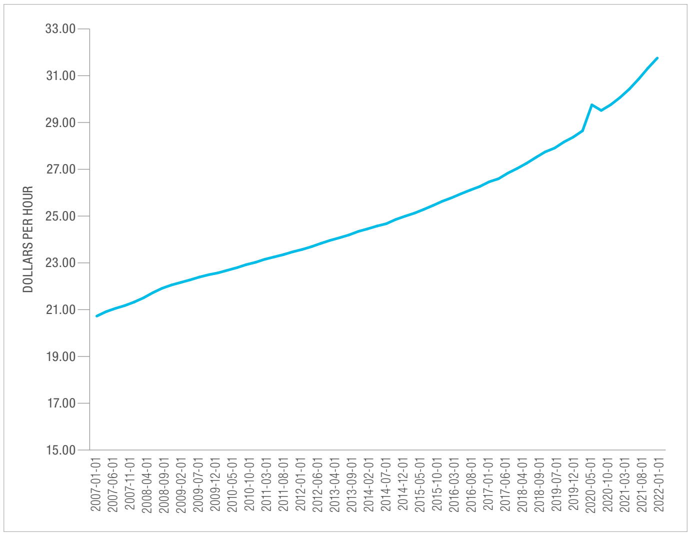
Job Creation and Destruction, 1978-2020



Source: U.S. Census Bureau—Center for Economic Studies—Business Dynamics Statistics, https://bds.explorer.ces.census.gov, accessed July 27, 2023.

The U.S. Census Bureau tracks the number of jobs created and destroyed each year. The number of jobs created grew from less than 15 million in 1978 to almost 20 million in 2001, while the number of jobs destroyed increased from less than 10 million in 1978 to over 20 million in 2001. Over the last decade, the number of jobs created and destroyed have hovered in the 15 million per year range.

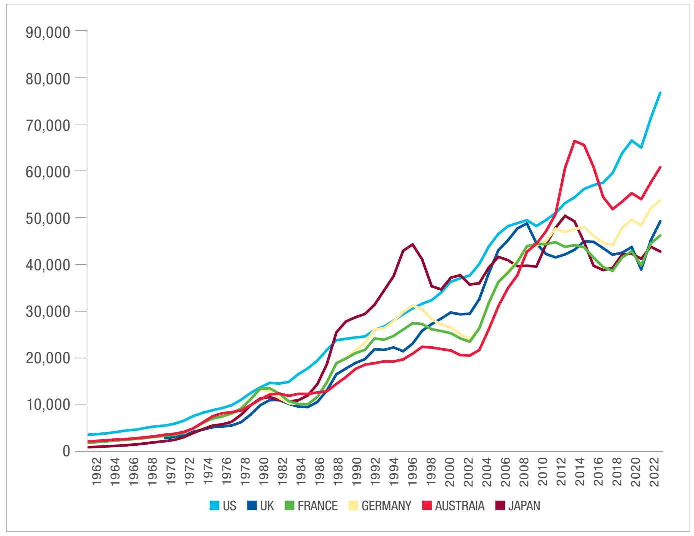
Average Hourly Wages Over Time, 2007-2021



Source: St. Louis Federal Reserve, https://fred.stlouisfed.org/series/CES0500000003, accessed 26 July 2023.

The overall hourly wage average, according to the St. Louis Federal Reserve database (FRED), has risen steadily, and the rate of growth appears to have picked up steam since the COVID pandemic started. This strength in hourly earnings does not, on its own, point to any necessary weakness in market competition. Decreasing hourly wages might be a red flag, but that is not the case. However, when we look at labor's overall share of GDP output, the data tells a different story.

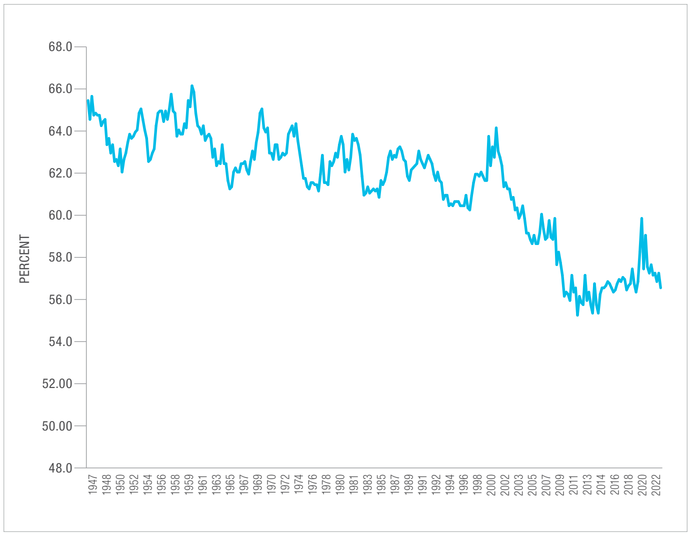
National Income Per Capita, 1972-2022



Source: World Bank, https://data.worldbank.org/indicator/NY.GNP.PCAP.CD?locations=AU-FR-DE-JP-GB-US, accessed July 27, 2023.

As estimated by The World Bank, adjusted net national income is defined as gross national income minus consumption of fixed capital and natural resource depletion. World Bank staff estimates are based on sources and methods in World Bank's "The Changing Wealth of Nations: Measuring Sustainable Development in the New Millennium" (2011).

Labor Compensation as Share of GDP, 1947-2023



Source: BLS Major Sector Productivity data. www.bls.gov/news.release/prod2.nr0.htm, accessed July 25, 2023.

This graph shows the share of total economic output that is paid as compensation to workers and can be compared to the share of output returned to owners of capital. Labor's share of income can fluctuate widely, but on average has declined since half a century ago. This trend makes it more difficult for standards of living to increase for the majority of workers. The decline from close to 66% in 1947 to 56% in 2023 indicate power shifting to either companies in the form of profits or to governments in the form of taxes. We know from an earlier dataset that corporate profits have increased, though they don't account for the full 10% drop in the labor share.

4. SOCIETAL IMPACT

Are there broader society-wide indicators that highlight the quality of competition?

The societal impact statistics tell us that American's are not satisfied with the current status quo. Trust in all institutions is under pressure, with trust in media seeing the greatest decline over the last ten years; trust in business remains highest. Additionally, public opinion is more pessimistic than reality. Trust in government is undermined by its shaky balance sheet, the apparent lack of accountability of government agencies, and the poor performance of public schools in terms of student achievement. Society's confidence in the market economy might be bolstered if the government was viewed as a trustworthy partner to foster limited market corrections when and where needed.

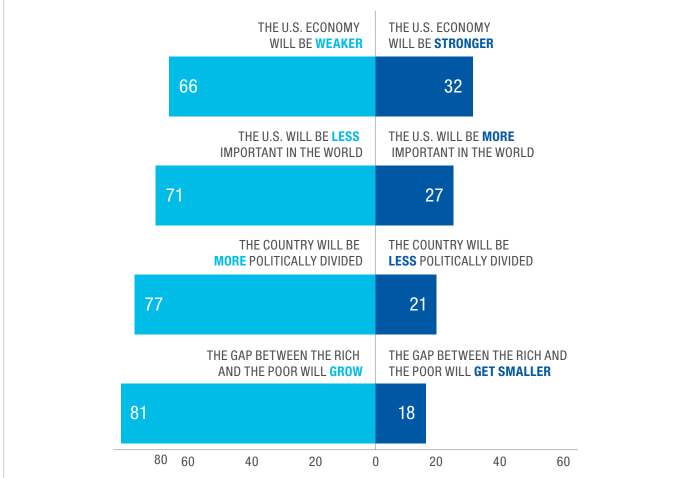
Basic Societal Expectations of Political & Economic Systems

- A RISING, WIDELY SHARED, AND SUSTAINABLE STANDARD OF LIVING
- GOOD JOBS FOR THOSE WHO CAN WORK AND ARE PREPARED TO DO SO
- EQUALITY OF OPPORTUNITY
- SECURITY FOR THOSE WHO NEED IT
- ENDING SPECIAL PRIVILEGES FOR THE FEW
- PRESERVATION OF CIVIL LIBERTIES FOR ALL

Source: Wolf, Martin. The Crisis of Democratic Capitalism. Penguin Press, 2023. pp. 230, 232.

This list is found in Martin Wolf's 2023 book, *The Crisis of Democratic Capitalism*. Wolf contends that citizens in a democratic society coupled with a market economy should expect that some will earn more, sometimes much more, than others. However, he states that "there should be enough equality to enable everybody to participate in society and ensure a reasonable degree of equality of opportunity."[18]

Public Outlook for Future of U.S. Democratic Capitalism, 2023

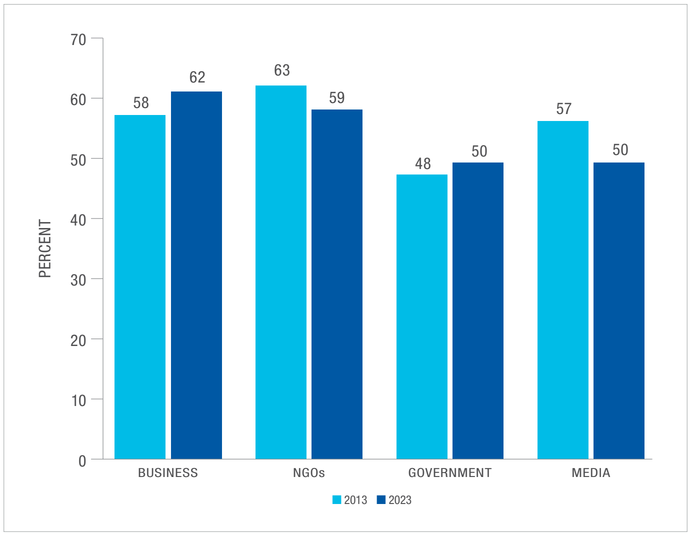


Source: Pew Research Center, April 2023, https://www.pewresearch.org/short-reads/2023/04/24/americans-take-a-dim-view-of-the-nations-future-look-more-positively-at-the-past/, accessed 30 September 2023.

According to a poll conducted by the Pew Research Center in April 2023, the American public is more pessimistic than optimistic about key aspects of democratic capitalism. The majority of those polled believe that, by the year 2050, the U.S. economy will be weaker, the U.S. will be less important on the world stage, the country will be more politically divided, and that the wealth gap between rich and poor will continue to grow wider.

[18] Wolf, Martin, *The Crisis of Democratic Capitalism*, Penguin Random House LLC, 2023, p. 232.

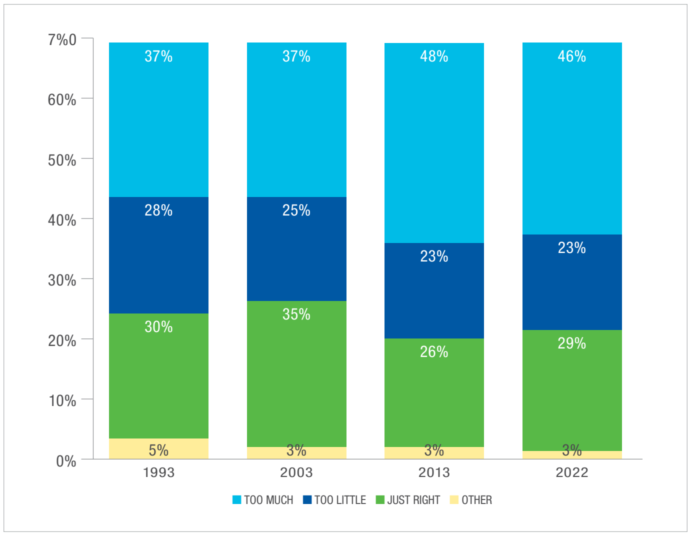
Trust in Institutions, 2013 vs. 2023



Source: Edelman Trust Barometer Global Report, 2013 and 2023; https://www.edelman.com/trust/2023/trust-barometer, accessed July 31, 2023.

For the last 22 years, Edelman has conducted an annual trust survey to gauge the public's trust in societal institutions (i.e., business, government, NGOs, and media) and institutional leaders. In the most recent addition, the firm surveyed more than 36,000 respondents in 28 different countries asking, "for each [institution], please indicate how much you trust that institution to do what is right." Those that received scores from 60-100 are deemed trustworthy, those from 50-59 are neutral, and those from 1-49 are considered to be distrusted. Currently, business is the only institution to barely hang on to a trustworthy ranking, while the rest are seen as neither trusted nor distrusted. Media has had the largest fall in trust over the time period.

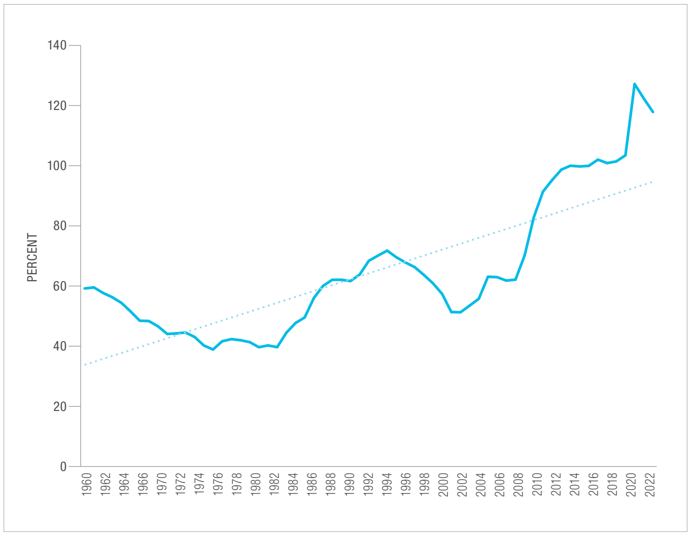
Views on Government Regulation on Business & Industry



Source: Gallup, https://news.gallup.com/poll/5248/big-business.aspx, accessed July 13, 2023.

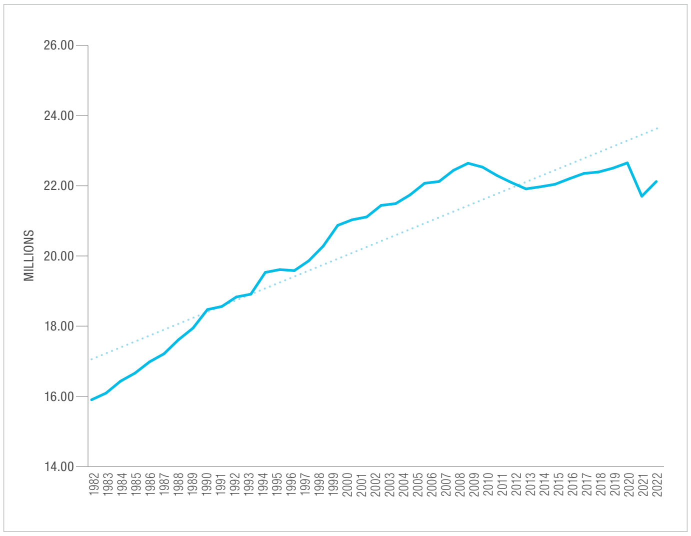
The majority of Americans view capitalism more favorably than socialism, and general perceptions of capitalism and socialism have remained relatively stable since 2010. Positive views of capitalism have remained around 60% while positive views of socialism trend slightly below 40%. Additionally, Americans' expectations of government have increased by more than 10% since 2010. The perception that business will harm society if it is not regulated has also increased by nearly 10% since 2010. However, most Americans believe that current business regulations are sufficient.

U.S. Government Debt as Percent of GDP, 1960-2022



Source: https://www.theglobaleconomy.com/USA/Government_debt/, accessed 12 September 2023.

Total Number of Government Employees, 1982-2022

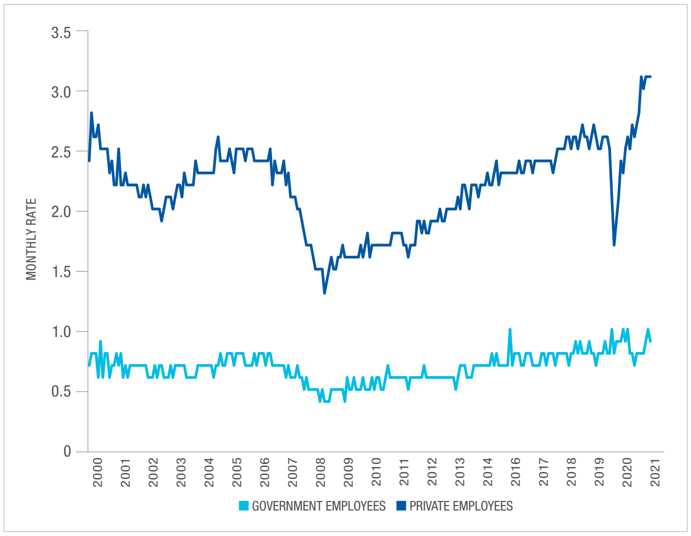


Sources: https://www.statista.com/statistics/204535/number-of-governmental-employees-in-the-us/, accessed 12 September 2023.

One troubling data point is the growing level of U.S. government debt. The measure has grown from lows of 40% to a recent high of over 120%. And the Congressional Budget Office is projecting U.S. debt to surpass 180% of GDP by 2053. High levels bring into question the credit of the U.S. government—and also raise the question of how capable the government will be as a future partner and problem-solver when it comes to market inefficiencies and/or failures.

Since 1982, the number of government employees at federal, state and local levels has grown from 16 million to over 22 million. Given the increase in regulation over a similar time period, the increase is not a surprise. Even if one can substantiate the need for this growth in government agencies, there are six million government employees that could be available to the private sector for jobs that, in theory, can increase overall GDP growth.

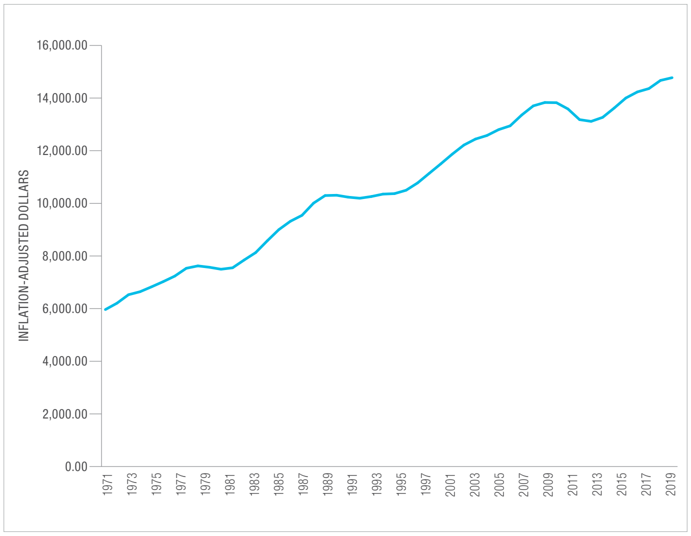
Government and Private Sector Employee Turnover, 2001-2021



Source: St. Louis Federal Reserve, https://fred.stlouisfed.org/series/JTS9000QUR & JTS1000QUR, accessed 26 July 2023.

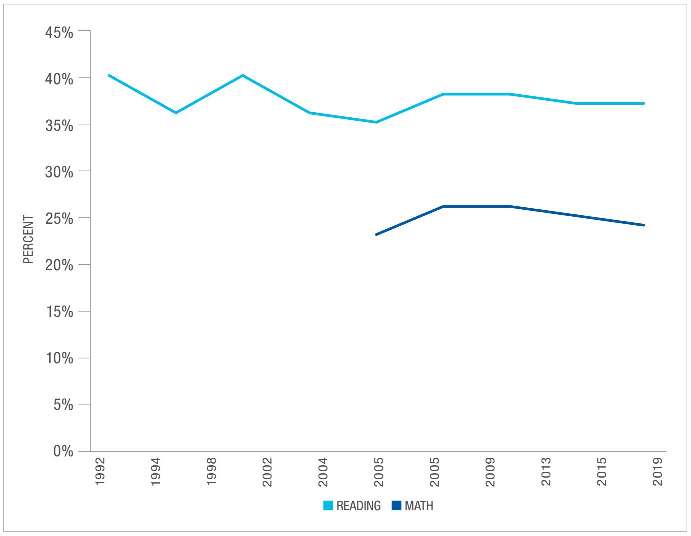
Critics often contend that government agencies are not held accountable by the same market forces that keep businesses and their management teams in check. In business, employees are generally held to certain performance standards that can result in probation or termination if performance does not improve. In government, though most agencies also adhere to performance standards for their employees, there is still a substantial difference in employee turnover. Over the last 20 years, employees in the private sector have experienced turnover rates ranging from 2 to 4.5 times that of government employees.

K-12 Total Spending Per Student, 1970-2020



Source: U.S. Department of Education, National Center for Education Statistics, 2022; and National Assessment of Educational Progress, 2021.

K-12 Proficiency in Math and Reading, 1992-2019



Source: U.S. Department of Education, National Center for Education Statistics, 2022; and National Assessment of Educational Progress, 2021.

Though not directly correlated with market competition, the performance of K-12 education is a good future indicator of a society's potential in all its productive and cultural pursuits. Since the early 1990s, spending per K-12 student has increased from $10,000 to $15,000, a 50% increase. However, over that same timeframe, K-12 student proficiency scores in reading and math have remained steady or declined, at 35-40% and 25%, respectively.

Deep Dive Case Studies

CASE 1: BABY FORMULA

In 2021, supply chain challenges and labor shortages related to COVID-19 led to rising out of stock rates for baby formula across the U.S. A voluntary recall of formula from Abbott Nutrition's Sturgis Michigan plant, related to complaints of bacterial infections led to major shortages across the U.S. occurred in February 2022.[19] The plant was temporarily reopened but flooding in the area caused it to shut down again quickly.[20] At the height of the crisis, out-of-stock rates hit 70% and panic over the shortage led to hoarding which artificially inflated demand and worsened the shortage.[21] The shortages impacted families across the country, especially as babies who have started formula cannot return to breastfeeding or eat any other types of food.

Concentration & Competition in U.S. Baby Formula Markets

Prior to the 2021 and 2022 shortage issues, the baby formula industry was highly concentrated. Three firms, Abbott, Mead-Johnson, and Nestle supply 98% of formula for U.S. markets and most of the remaining supply is accounted for by Perrigo, who produces generic brands of formula for major retail stores.[22] The high level of concentration enables the companies to exercise market power, raise prices, and invest in lobbying and regulatory capture.

Additionally, market concentration also concentrates risk to fewer firms and plants. Concentration means that higher percentages of the formula produced come from fewer plants, suppliers, etc. This means that any one piece of the supply chain failing, such as the failure of 1 of 21 formula producing-plants,[23] has a greater likelihood of causing a system failure or widespread shortage.[24] This also means that any incident of contamination or food-borne illness is more likely to affect a larger number of consumers than if the industry were more diversified.[25]

The Impact of Government Policies on Competition

In addition to the effects of the high level of concentration in U.S. formula markets, competition is also impacted by government policies including FDA regulations, trade protections, and government procurement processes. FDA regulations have long prioritized consumer safety and quality control. However, because they have not factored in concerns about price, supply chain risk, or competition, some regulations have led to consolidation and barriers to entry.[26] Similarly, trade protections have prevented foreign formula companies from entering and/or competing aggressively in U.S. markets[27] through a range of policies including high tariffs and tariff rate quotas, a prohibition on EU imports due to FDA labeling standards, and the 2020 U.S.-Mexico-Canada Agreement, which raised restrictions on Canadian imports.[28]

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[19] FDA. (February 2022). "FDA investigation of Cronobacter infections: Powdered infant formula." FDA. Retrieved from: https://www.fda.gov/food/outbreaks-foodborne-illness/fda-investigation-cronobacter-infections-powdered-infant-formula-february-2022.

[20] Pathak et al. (June 17, 2022). *The National Baby Formula Shortage and the Inequitable U.S. Food System.* Center for American Progress. Retrieved from: https://www.americanprogress.org/article/the-national-baby-formula-shortage-and-the-inequitable-u-s-food-system/.

[21] Chang, J. & Chakrabarti, M. (May 19, 2022). "The corporate monopolies behind the national baby formula shortage." WBUR. Retrieved from: https://www.wbur.org/onpoint/2022/05/19/the-corporate-monopolies-behind-americas-baby-formula-crisis.

[22] Pathak et al. 2022.

[23] FDA Oversight Part I: The Infant Oversight Shortage: Hearing before the U.S. House of Representatives Subcommittee on Health Care and Financial Services, 118th Cong. (2023). https://oversight.house.gov/wp-content/uploads/2023/03/Yiannas-Testimony_-House-Subcomm_March-27-2023.pdf.

[24] Graham, S. (2009). *Disrupted cities when infrastructure fails.* Routledge. https://doi.org/10.4324/9780203894484 p. 31-33.

[25] FDA Oversight Part I 2023, p. 12.

[26] Chang & Chakrabarti 2022.

[27] Chang & Chakrabarti 2022.

[28] Linicome, S. & Beaumont-Smith, G. (2023, February 16). "The infant formula market is still bottled up." Cato Institute. Retrieved from: https://www.cato.org/commentary/infant-formula-market-still-bottled.

Competition in the U.S. formula market is shaped by government procurement process because an estimated 56% of formula consumed is purchased by state agencies and distributed through the Special Supplemental Nutrition Program for Women, Infants and Children (WIC).[29] Each state selects a single manufacturer for the state contract and their formula is the only product eligible for WIC benefits.[30] Since more than half of consumers purchase formula through WIC, and WIC customers are limited to the contracted brand, stores are not incentivized to stock any other company's formula.[31] When a firm wins a new state contract, their market share increases by approximately 74%.[32]

CASE 2: NEWS

News has long been a pillar of democratic society.[33] A robust and independent press plays many important roles that strengthen democracy including keeping citizens informed, promoting civic engagement and dialogue, serving as a tool for communication and education between experts and the public, as well as exposing wrongdoing and facilitating public accountability. Since the news media is so essential to American society and democracy, the economic health of the news is especially concerning.[34]

Concentration of the News

The media, which is essential to informing and educating citizens, is becoming an increasingly concentrated industry. Over the last two decades, local and small news outlets have closed at unprecedented rates and larger national outlets have become increasingly concentrated. 1,800 newspapers closed between 2004 and 2020 and the circulation of surviving papers has also declined.[35] Out of more than 3,000 counties in the U.S., half have only one local paper and a further 200 have no local news at all.[36]

The loss of local media outlets has created a gap in coverage of local and regional news issues.[37] The lack of local coverage has contributed to the loss of a sense of community and shared identity. As news coverage increasingly focuses on national issues, news has become less personally relatable to people's lives and communities and has fostered a sense of polarization and isolation.[38] Both the loss of local coverage and the concentration of remaining outlets have contributed towards a decline in trust of the media and experts more broadly. This loss of trust and more limited news coverage has created a space for misinformation, which has further contributed to polarization and radicalization.

In addition to shrinking coverage of local issues, the quality of the remaining local coverage has declined.[39] The consolidation of local outlets by private equity buyers and large holding companies has led to cost cutting efforts which have reduced the quality of local news coverage and eliminated journalism jobs.[40] Additionally, these holding companies are part of a broader trend of concentration within the news industry. The industry is also experiencing increased concentration due to mergers and the rise of aggregate news distribution platforms.[41]

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[29] USDA Economic Research Service. (May 23, 2022). "Infants in USDA's WIC program consumed an estimated 56 percent of U.S. infant formula in 2018." USDA. Retrieved from: https://www.ers.usda.gov/data-products/chart-gallery/gallery/chart-detail/?chartId=103970#:~:text=The%20share%20of%20formula%20in,to%2058%20percent%20in%202005.

[30] Oliveira, V. & Frazão, E. (March 1, 2010). "Most infant formula purchased through WIC." USDA. Retrieved from: https://www.ers.usda.gov/amber-waves/2010/march/most-infant-formula-purchased-through-wic.

[31] Chang & Chakrabarti 2022.

[32] Pathak et al. 2022.

[33] Repucci, S. "Media freedom: A downward spiral." 2019. Freedom House.

[34] Ardia et al., "Addressing the rise of local news." CITAP. 2020.

[35] Dayen, D. *Monopolized.* 2020.

[36] Abernathy, P. "Do you live in a news desert?" UNC Hussman School of Journalism and Media. 2023. Retrieved from: https://www.usnewsdeserts.com/.

[37] Pickard, V. "The year journalism and capitalism finally divorce." 2022. Nieman Lab.

[38] Pickard, 2022.

[39] Hendrickson, C. "Local journalism in crisis." Brookings. 2019.

[40] Hendrickson, 2019.

[41] Dayen, 2020, p. 83-84.

Competition in the News

The concentration of media outlets has been driven by concentration and anti-competitive behavior from technology firms, especially in social media and digital advertising markets, which have undercut traditional revenue models for the news as an industry.[42] News consumption has been changing in recent decades from physical print newspapers towards social media platforms. The "vast referral networks," of social media platforms have become a market force that shapes how news outlets design their content and compete for market share.[43] Since social media and technology platforms have increasingly taken on the role of distributing news content,[44] concentration in social media platforms and digital advertising, are driving concentration within the media.

Historically, news outlets have made most of their revenue through advertising and subscription but both sources of revenue have been declining in recent years.[45] Over the last decade, ad revenue for newspapers has dropped nearly 70%,[46] as tech platforms have consolidated digital advertising markets. Google and Facebook have accounted for the vast majority of annual growth in ad revenue markets.[47] Additionally, by late 2019, Google accounted for 60% of all display ad inventory sold on U.S exchanges and 80% of ad sales for high-value users.[48]

CASE 3: AIRLINES

Flight delays and cancellations have become increasingly common, including multi-day events with thousands of flight cancellations leaving travelers stranded across the U.S.[49] These delays are not only frustrating for travelers but also disrupt important transportation linkages that bring social and economic benefits to communities.[50] The high concentration within the U.S. airline industry is creating growing vulnerability to systemic delays and failures and is isolating smaller cities and rural areas from economic opportunity.

The Concentration of the Airline Industry

The U.S. airline industry is highly concentrated. The four largest firms (American, Delta, United, and Southwest), account for 60% of domestic flights and 80% of U.S. based international travel.[51] Additionally, since the airline industry has strong barriers to entry,—including high startup costs, competition for airport gate and flight slots, and large economies of scale[52]—between 2007 and 2021, no new airlines entered the market.[53]

Originally, airlines were regulated by the Civil Aeronautics Board, which mandated industry prices and flight destinations.[54] Airlines were deregulated in 1978 to introduce price flexibility, make tickets more affordable, and introduce more competition to the industry.[55] Deregulation did drop prices, by 1990, airfare had declined by approximately 30%

[42] Dayen, 2020, p. 73.
[43] Dayen, 2020, p. 74.
[44] Hendrickson, 2019.
[45] Grieco, E. "Fast facts about the newspaper industry's struggles as McClatchy files for bankruptcy." Pew Research Center. 2020.
[46] Hendrickson, 2019.
[47] Dayen 2020, p. 75.
[48] CheckMyAds. "Google Ads has become a massive dark money operation." October 2022.
[49] Stock et al. "Flight delays, cancellations could continue for a decade amid airline workforce shortage." CBS News. (2023, July 25). Retrieved from: https://www.cbsnews.com/news/the-future-of-flying-more-delays-more-cancellations-more-chaos/.
[50] Dayen, 2020, p. 23.
[51] Baldanza, B. "Where the U.S. airlines fit on a traditional monopoly game board." Forbes. 2023.
[52] Wolla & Backus, "The economics of flying." St. Louis Fed. 2018, p. 3.
[53] Semuels, "Airlines are terrible. Small cities are still stuck paying them millions to stick around." Times. 2023.
[54] Semuels, 2023.
[55] Wolla & Backus, 2018, p. 1.

from 1976 levels.[56] However, deregulation also resulted in rapid industry concentration first through firm exit then mergers and acquisitions. 200 airlines went bankrupt by 1988, as competition pushed fares unsustainably low.[57] The bankruptcies of the 1980s were followed by a wave of mergers throughout the 1990s,[58] followed by subsequent waves after 9/11 and during the Great Recession.[59] Over time, the industry became increasingly concentrated, resulting in the four major airlines that dominate U.S. markets today.[60]

In addition to price competition and looser merger and acquisition policies, deregulation also allowed airlines to select their own flight destinations. Airlines chose to shift away from cross-country direct flights towards a new model that transferred connections through hubs.[61] Hubs centralize operations, reduce personnel and equipment costs,[62] and cut down on less profitable flights.[63]

Impacts of Airline Concentration

Concentration of Risk

By design, the hub model generates efficiencies by concentrating flights to a smaller number of airports. However, this also concentrates risks of delay and system failure. More flights moving through a smaller number of airports increases the potential for bottlenecks that result in congestion and delays.[64] A weather event, security issue, or other disruption at one hub is more likely to effect a large percentage of travelers and to slow down the whole system than if flights were dispersed to a wider variety of locations.[65] Airlines have optimized efficiency to the detriment of resiliency, there is little slack or redundancy in the system that can be used to prevent a shock or crisis from cascading through the whole system.

Similarly, since industry concentration means that a smaller number of carriers service more flights, one airline's technical issues are increasingly likely to effect a larger number of travelers.[66] This concentration of risk is compounded by the failure of airlines to update their technology after mergers,[67] "instead piling one legacy system of reservations and flight departures and crew schedules on top of another."[68] Since all of the major airlines have followed similar practices in IT updates, and there is such limited competition for customers to turn to, there is little incentive for airlines to fix these systems.[69]

Impacts on Smaller Cities and Rural Areas

Concentration of the airline industry has resulted in less access for smaller communities. "Since 2019, 14 airports in the U.S. have lost all scheduled commercial air service [and] the three biggest U.S. airlines—American, Delta, and United—have pulled out of 68 cities combined since April 2020."[70] The loss of air service often results in businesses pulling out or deciding not to open new facilities in a community, a decline in tourism, and lower rates of new res idents moving to the area,[71] all of which combine to send communities into economic decline.

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56 Wolla & Backus, 2018, p. 2.
57 Dayen, 2020, p. 24.
58 Dayen, 2020, p. 24.
59 Wolla & Backus, 2018, p. 2.
60 Wolla & Backus, 2018, p. 1.
61 Dayen, 2020, p. 27.
62 Dayen, 2020, p. 27.
63 Semuels, 2023.
64 Dayen, 2020, p. 27.
65 Dayen, 2020, p. 29.
66 Dayen, 2020, p. 29.
67 Tufekci, Z. "The shameful open secret behind Southwest's failure." *The New York Times.* December 31, 2022. Retrieved from: https://www.nytimes.com/2022/12/31/opinion/southwest-airlines-computers.html.
68 Dayen, 2020, p. 29-30.
69 Dayen, 2020, p. 30.
70 Semuels, 2023.
71 Semuels, 2023.

The concentration of flights into hub airports and shrinking number of airports overall contribute to the growing economic divide between smaller cities and rural communities and "superstar" cities. Importantly this economic division also coincides with geographic trends in access to opportunities, health disparities, and politics.[72] Superstar cities reliably trend Democratic and more rural areas Republican, and since Senate and Electoral College representation is not linked to population, "partisan sorting contributes to a crisis of unrepresentative government,"[73] where increasingly large portions of American citizens are represented by fewer senators and electors.

CASE 4: DEFENSE

The defense industrial base (DIB), companies that provide services to the Department of Defense (DoD), is a crucial component to America's national security.[74] The DoD has been increasingly concerned about ensuring a strong and competitive DIB, focusing on barriers to entry, innovation, surge capacity, as well as a skilled workforce and domestic manufacturing capability.[75] An overly concentrated defense sector has negative economic and national security implications and can limit the U.S. military's agility.[76]

Concentration of the Defense Industrial Base

The defense industry has become increasingly concentrated. Since the 1990s, the number of prime aerospace and defense contractors has dropped from 51 to 5 firms.[77] The DIB is also increasingly concentrated geographically, with 75% of defense spending on prime contracts going to just 15 states and more than 60% to the top 10 states.[78] Additionally, the number of small businesses in the DIB has shrunk by more than 40% over the past decade and without action and it risks losing another 15,000 suppliers in the coming decade.[79] The defense industry began to concentrate after the end of the Cold War led to a decline in federal defense spending. In the 1990s, in addition to cutting defense spending, the Clinton Administration encouraged defense contractors to merge and consolidate.[80] During the same period, Congress pursued acquisition reform in order to modernize government processes and make them more business friendly.[81] Acquisition reform enhanced contractor leverage and profits, and reduced accountability competition. Such changes included broadening the definition of 'commercial items,' and outsourcing previously in-house functions to contractors.[82] These changes led to risks such as supply chain concentration and national security issues.

Impacts of Defense Concentration

Concentration of the DIB has resulted in interrelated[83] consequences including: reduced domestic manufacturing capacity, the concentration of risk, erosion of supply chain resiliency, and increased market power.[84] The reliance on single, often offshore suppliers, creates domestic vulnerability to price hikes and dependence on overseas supply chains.[85] Furthermore, concentration has coincided with increased

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72 Sitaraman et al., "Regulation and the geography of inequality." Duke Law Journal. 2020, p. 1765.

73 Sitaraman et al. 2020, p. 1766.

74 White House Fact Sheet.

75 DOJ/FTC Statement, p. 1.

76 Tippett, A. "To protect U.S. economic and national security, Biden should address concentration in the defense sector." Council on Foreign Relations. (2021, August 25). Retrieved from: https://www.cfr.org/blog/protect-us-economic-and-national-security-biden-should-address-concentration-defense-sector#:~:text=While%20defense%20sector%20concentration%20is,it%20competes%20with%20potential%20adversaries.

77 Office of the Under Secretary of Defense for Acquisition and Sustainment. *State of Competition within the Defense Industrial Base.* (February 2022). Department of Defense. Retrieved from: https://media.defense.gov/2022/Feb/15/2002939087/-1/-1/1/STATE-OF-COMPETITION-WITHIN-THE-DEFENSE-INDUSTRIAL-BASE.PDF.

78 Berenson, D. "The evolving geography of the U.S. industrial base." *War on the Rocks.* (2021, September 1). Retrieved from: https://warontherocks.com/2021/09/the-evolving-geography-of-the-u-s-defense-industrial-base/.

79 White House Fact Sheet.

80 Loeb, R. "Caveat Emptor: Reversing the Anti-Competitive and Over-Pricing Policies that Plague Government Contracting." American Economic Liberties Project. (2020, June 30). Retrieved from: https://www.economicliberties.us/our-work/caveat-emptor-reversing-the-anti-competitive-and-over-pricing-policies-that-plague-government-contracting/.

81 Dayen, D. *Monopolized.* The New Press. 2020; Stoller, M. "The Pentagon Turns on Wall Street." BIG by Matt Stoller, (Feb. 11, 2021). Retrieved from: https://www.thebignewsletter.com/p/the-pentagon-turns-on-wall-street.

82 Loeb, 2020, p. 7-11.

83 Stoller, M., & Kunce, L. "America's monopoly crisis hits the military." *The American Conservative.* 2019, June 27. Retrieved from: https://www.theamericanconservative.com/americas-monopoly-crisis-hits-the-military/.

84 Stoller, 2021.

85 Dayen, 2020.

lobbying power which can cause political challenges when the DoD tries to shift away from legacy systems. Lobbying coalitions can also cause the DoD to pay for products that the industry wants to produce instead of what meets the military's needs.[86]

Domestic Manufacturing Capacity

Many defense contractors have chosen to offshore production due to short-term financial considerations such as labor costs and broader market concerns.[87] However, locating large portions of the DIB manufacturing abroad has created security concerns and reduced U.S. manufacturing capacity.[88] Especially where the DoD must rely on "single-source domestic products and foreign supply chains, particularly through "competitor nations like China,"[89] where there is risk of export bans and counterfeit or sabotaged goods is heightened. This decline in domestic manufacturing and transition toward a more service-based economy has resulted in a loss of domestic capacity and skill-building, weakening the labor force.

Concentration of Risk & Supply Chain Resiliency

The concentration of DIB firms has also concentrated risks. As the DIB consolidated, the DoD became increasingly reliant on the shrinking number of contractors and production facilities remaining.[90] This increased the potential for a disruption (a technical issue, weather disruption, or deliberate attack) to cause delays or shortages for a wider portion of the system and made the supply chain less resilient.[91] Concentration has also eliminated redundancy within the system,[92] removing excess capacity that could be relied on in times of crisis or sudden demand.[93]

Market Power & Effects for the U.S. Military

A lack of competition in the DIB, along with the structure of federal procurement processes has led to price increases, regulatory capture, and disincentivized innovation, timely service, and quality goods.[94] Some contractors have targeted procurement processes to overcharge the DoD and, through them, the American taxpayer. Contractors have sought to avoid long-term contracts in order to hike prices annually and constructed sales and order processing strategies to avoid audits and disclosing cost information.[95] A key example of this is the TransDigm price setting case where after becoming the sole-source provider of parts that were difficult to substitute due to safety and production requirements, sold to original manufacturers at a low price and then sold replacement parts to the DoD for a high price.[96]

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Reactions: Betsey Stevenson and Michael Strain

Two economists—Betsey Stevenson (University of Michigan) and Michael Strain (American Enterprise Institute)—share their views on the current state of democratic capitalism and the quality of market competition in the United States.

The Resilient and Adapting Economy

AN ESSAY BY BETSEY STEVENSON (NOVEMBER 2023)

Both GDP and the labor market have proven to be more resilient over the past 12 months than many predicted. By the end of 2022, anxiety over a potential recession was rising rapidly and continued to accelerate in 2023. In October 2022, a Bloomberg headline declared "Forecast for US Recession Within Year Hits 100%" and went on to declare that a recession was "effectively certain in the next 12 months."

Since that declaration, the U.S. economy has added nearly 3 million new jobs and real GDP has grown by 2.7 percent. Not only was there no recession, but the economy has outperformed expectations at almost every turn. In September 2022, the Federal Open Market Committee projections were for the U.S. economy to grow by 0.2 percent in 2022 and 1.2 percent in 2023. A year later real GDP was estimated to have grown 1.9 percent in 2022 and Fed projections for growth in 2023 had been revised up to 2.1 percent above the Fed's forecast for long-run real growth of 1.8 percent. Professional forecasters showed similar patterns of under-estimating U.S. growth in 2023 as the year began. At the start of 2023, the Bloomberg consensus was that economic growth in 2023 would be below 1%.

Employment has grown sharply and is now back to the pre-pandemic employment growth trendline. Unemployment has remained exceptionally low. In the 21st century, the unemployment rate has averaged 5.8%. In 2022, the unemployment rate was 3.6%. The last time the annual unemployment rate was lower was in 1969. In the first 10 months of 2023 it has also averaged 3.6%. While it has ticked up in the second half of the year, it remains below 4%.

The number of jobs available as indicated by data on job openings has come down since peaking in March 2022. At the peak, there were twice as many job openings as there was prior to the pandemic. As of September 2023, there were 9.6 million job openings compared to 7.2 million in September 2019.

Despite ongoing elevated numbers of job openings, hiring has returned to pre-pandemic levels.[97] The slowdown in hires and the ticking up of the unemployment rate indicate that the labor market is slowing slightly.

One of the big questions last year was whether workers would return to the labor market to fill these openings. The answer has been yes. Ultimately the Federal Reserve Open Market Committee will likely be credited with steering us toward a soft landing—bringing down inflation without causing a recession. However, this was clearly a worker and consumer driven boom. Workers entered the labor market to fill job openings, demanding wage increases that were sufficient to generate wage compression but did not generate a wage-price spiral.

Consumer spending has remained above trend despite the Fed's efforts to raise interest rates to reduce demand. New business formation surged in 2022 and has continued well into 2023. Ongoing consumer spending, and perhaps the surge in business formation as well, has been helped by

[97] The Bureau of Labor Statistics Job Openings and Labor Turnover Survey began in 2000.

household's strong balance sheets and the moratorium on student debt. Inflation adjusted median net-worth jumped in 2022 compared to 2019 by more than any other three-year period since the Federal Reserve began its comprehensive survey of consumer finances more than thirty years ago.

But not everything is rosy: the challenge has been rising prices. Inflation peaked at 9% in June 2022 and has subsequently fallen to 3.2% as of October 2023. While current inflation is within normal rates, the brief period of high inflation has sparked economic anger and frustration.

In short, we began the year with many predicting a recession, and yet we are ending the year with unemployment remaining near 50-year lows and GDP and employment growth that is above trend. While the economy is slowing, it is slowing toward the elusive soft landing in which inflation returns to the Fed's 2 percent target with unemployment staying low.

This essay explores our current economy and labor market, potential lessons about government support, and highlights challenges on the horizon. Many of the challenges pre-date the pandemic.

Household Balance Sheets and Government Support

The typical American has gotten a lot richer than they were prior to the pandemic. The Federal Reserve's comprehensive survey of consumer finances laid out gains in net-worth and family income, all while debt stayed low relative to the period before the pandemic. While those with the most education and the highest net worth saw the biggest gains in median income from 2019 to 2022, the increase in net worth was seen across the income distribution.

Much of the boost to balance sheets came from the support that the government offered families and businesses during the pandemic. This swelled the coffers of families throughout the income distribution. However, one group—student loan holders—may have benefited the most. Interest was suspended in March 2020, and thus with zero interest, inflation eroded the value of the debt. Moreover, for those enrolled in an income-driven repayment plan, such as public service forgiveness, the more than three year moratorium counts toward their required period of payments before loans are forgiven.

But government support isn't the only reason that household wealth rose. The stock market and housing prices soared over this time period helping contribute to the nearly one-third increase in the average real value of families' financial assets.

Rising household wealth may offer a partial explanation as to why older Americans have not returned to the labor force to the same extent as younger workers. Among people ages 65 to 74, inflation-adjusted mean net worth rose 27%. The baby boomers were expected to keep working long past when previous generations retired, but the surge in wealth has allowed more of them to stay out of the labor force than expected.

Researchers will undoubtedly spend decades assessing the direct link between the forms of government support offered, the private sector response to the pandemic, global linkages, and the vibrant response of household spending and labor force participation. However, even now it is clear that supporting families and businesses during the worst days of the pandemic did not create a generation of people detached from the labor force. It contributed to a demand-led recovery that has proven to be much more resilient than past recoveries.

The high demand coming out of the pandemic was met by record-breaking growth in business formation. Applications for new businesses reached an all-time high in July 2020 and have remained historically elevated through mid-2023. The Federal Reserve's survey of consumer finances showed that in 2022, 1 in 5 families owned a privately held business, the highest share on record. The expanded safety net and reduction in debt may have provided an incentive for Americans to take the risk of forming a new business.

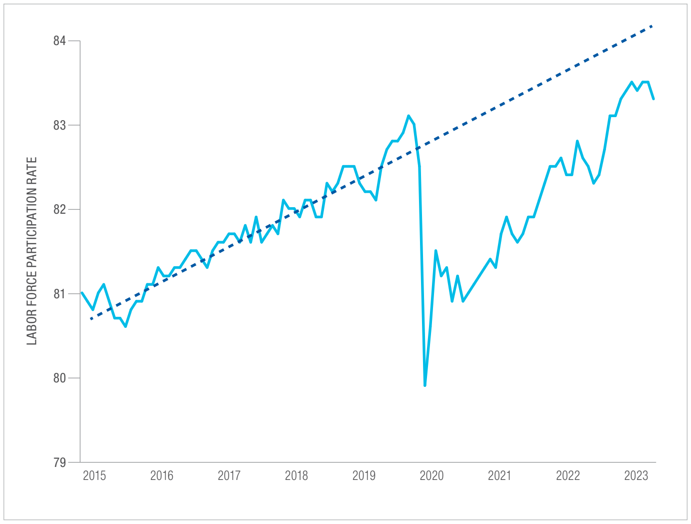
Labor Force Participation

Labor force participation has recovered most strongly among prime age adults—those ages 25 to 54 (see Figure 1). A larger share of the prime age population is participating in the labor force and, with the low unemployment rate, a larger share are employed today than in 2019. However, the counterfactual of where would the labor market be today without the pandemic is challenging because it is unclear whether the upward growth in labor force participation that occurred between 2015 and 2019 would have continued. Measured against the 2015 to 2019 trend growth in labor force participation, prime age labor force participation remains below what that trend would have generated.

Prior to the pandemic prime age women's labor force participation was growing much more strongly than that of men, rising by nearly 3 percentage points between 2015 and the end of 2019. While it has not kept up with that trend growth, it has surpassed the pre-pandemic peak and has continued to narrow the gap with the trend line over the past year (see Figure 2). In contrast, prime age male labor force participation grew more slowly following the 2008 recession. While there was upward growth between 2015 and 2019, male labor force participation has never fully recovered from the 2008 recession. In February 2020 prime age male labor force participation was 89.2%, well below the January 2008 rate of 91.1%.

Figure 1: Prime Age Labor Force Participation

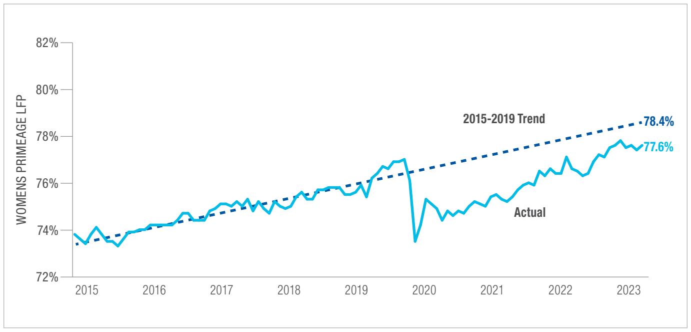
Share of population ages 25-54 either working or looking for work



Seasonally adjusted data.
Source: Bureau of Labor Statistics. Created with Datawrapper.

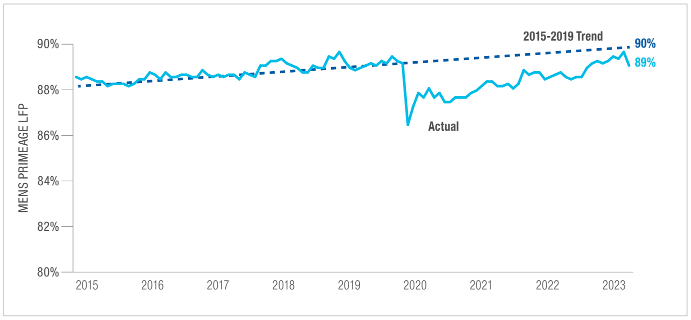
Figure 2: Prime Age Labor Force Participation Rate vs Prior Trend

Share of women ages 25-54 who are working or looking for work



Seasonally adjusted data
Source: Bureau of Labor Statistics. Created with Datawrapper.

Share of men ages 25-54 who are working or looking for work



Seasonally adjusted data
Source: Bureau of Labor Statistics. Created with Datawrapper.

In the current recovery, prime age male labor force participation has been at or above the February 2020 rate for much of 2023 but fell below it in October.

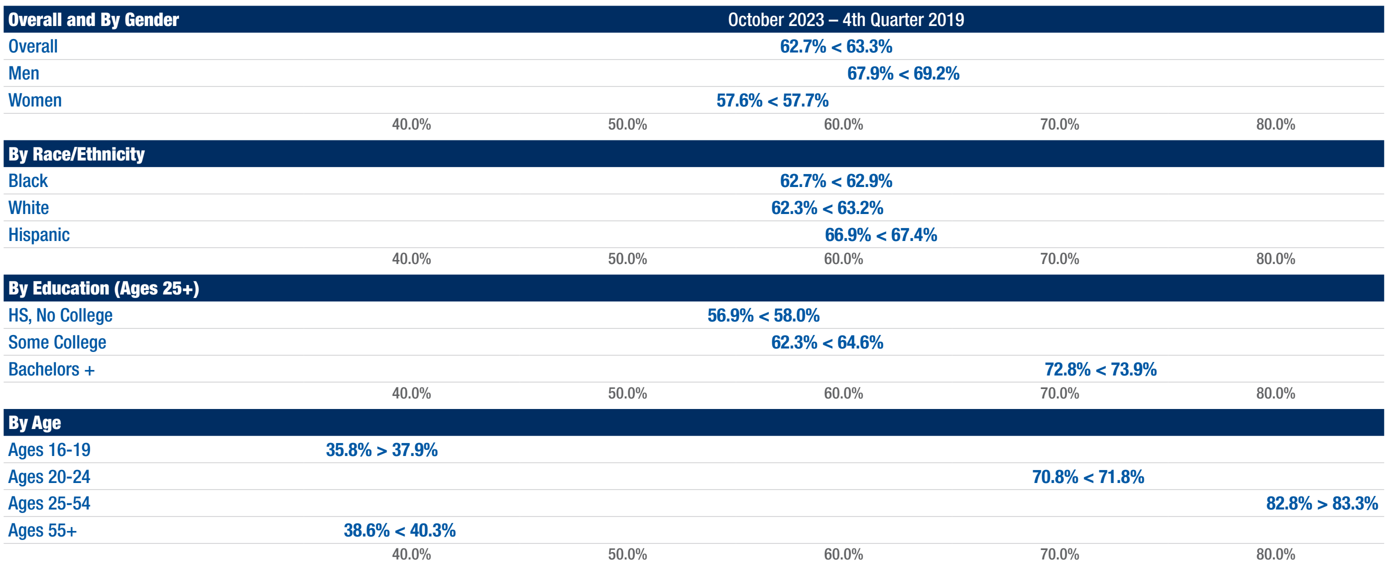
That female labor force participation continues to grow to new record highs, while male labor force participation struggles to recover points to both a place for optimism and a place for concern. The labor market and the economy more generally has left many men behind as it has evolved. Lower educated men have had some of the largest declines in labor force participation over time. There is a large literature examining this trend and many have argued that declining participation has been at least somewhat explained by declining labor demand, particularly among low-skill and middle-skill workers.[98]

The surge in labor force participation was essential to ensure that the economy could bring down inflation while keeping unemployment low. Workers' supply response to the tight labor market ensured that there was not inflationary competition over a fixed supply of workers. Beyond helping the economy achieve a soft landing from the high inflation, the experience of the labor market in the post-pandemic era suggests that a tight labor market may be essential for the U.S. to operate at its true potential, involving a large and growing share of people in the economy.

Stepping back and examining at all adults, labor force participation remains below that of the fourth quarter of 2019, largely reflecting the ongoing aging of the population and the slow recovery of labor force participation among older adults (see Figure 3). As noted above, labor force participation among those over age 65 has failed to recover following the covid pandemic drop. However, in the second half of 2023, labor force participation grew strongly for those ages 55 to 64, particularly among women whose labor force participation hit a record high. Prior to the pandemic labor force participation was rising among older adults,

Figure 3: Labor Force Participation Oct. 2023 vs. 4th Quarter 2019

Share of population working or looking for work



Seasonally adjusted data. Ages 16+ except where otherwise noted

Source: Bureau of Labor Statistics. Created with Datawrapper.

[98] Aaronson, S., Cajner, T., Fallick, B., Galbis-Reig, F., Smith, C., & Wascher, W. (2014). Labor Force Participation: Recent Developments and Future Prospects. *Brookings Papers on Economic Activity,* 197–255. http://www.jstor.org/stable/43233868.

particularly among those with more education. While the pandemic undoubtedly had a permanent impact on narrow cohorts of older Americans who retired early into the pandemic, the post-pandemic boom may help keep older Americans in the labor force in the coming years.

As with prime age adults, among all adults, male labor force participation has been weaker than that of women. Women's labor force participation in October 2023 is roughly the same as that in the fourth quarter of 2019. In contrast, male labor force participation is 1.3 percentage points lower.

Turning to race, the labor force participation rate among black workers is slightly higher to that prior to the pandemic, while it has fallen by a percentage point among white workers. Labor force participation rates among Hispanic workers have fallen by half a percentage point.

Black employment has recovered much more robustly than employment among whites. While long-standing gaps remain in the labor force participation rates of prime age workers by race in the post-pandemic labor market, this convergence in employment rates is notable. Between August 2022 and July 2023 an average of 77.3% of prime aged Black people were employed, more than any other 12-month period on record.

The recovery among Black workers is particularly notable because they were more likely to get laid off during the pandemic because of their disproportionate employment in the in-person service industries and the early months of the pandemic harmed Black workers with COVID-19 outcomes far worse than for whites. The strong improvements for Black workers illustrates how tight labor markets can have larger impacts on some groups of workers.

This greater improvement in labor force participation has occurred at a time of increased wage compression, with more rapid wage growth going to lower wage workers relative to higher wage workers.[99] Autor et al. find that this compression counteracted nearly 40% of the increase in the growth in the 90-10 log wage inequality. Black workers are disproportionately employed in low-wage occupations, as such they benefited disproportionately from the wage compression.[100] Autor et al.'s analysis finds an important role for the surge in labor market dynamism including record high quit rates in explaining which workers experienced the most real wage growth.

Research following previous recessions has found that displacement from jobs during recessions can have lifelong impacts on people's careers. The pandemic recession differed from previous recessions in two important ways. The first was that job loss was concentrated in the high-turn over service sector. The second was that the post-pandemic period was a time of record dynamism in the U.S. economy both in terms of business formation and job churning. Many of the workers who lost their jobs during the pandemic have found for job and wage improvements through the transition.

Unions and Labor Actions in 2023

Workers have come out of the pandemic with more bargaining power than they have had in decades. This fueled wage growth for workers willing to change jobs and change

[99] David Autor, Arindrajit Dube & Annie McGrew, "The Unexpected Compression: Competition at Work in the Low Wage Labor Market" NBER Working Paper 31010, November 2023.

[100] See Figure 17 of Autor, et al.

employers, as seen in the research on the reduction in wage inequality. But for workers with fewer opportunities to take their labor elsewhere, wages were more likely to stagnate.

Strikes and labor actions are up by more than 50% in 2022 and are on track to be even higher in 2023.[101] One reason for these labor actions is that the wages of unionized workers did not keep up with those of non-unionized workers, reducing the union wage premium.[102] For some unionized workers, like the UAW, their existing contract did not protect them from higher inflation. For example, the UAW signed a contract four years ago that gave up cost of living increases to get greater profit-sharing. This concession might have been a smart move in 2019, but it proved unlucky in light of post-pandemic inflation rates. Moreover, the UAW workers were still feeling the loss of what they had given up to save the auto industry during the Great Recession. The union chant of "record profits, record contracts" was a rallying cry that spoke to union workers and to the American public.

Unions faced a challenging situation at the start of 2023. Just 6.0 percent of private sector workers were unionized in 2022. A higher share of the public sector is unionized bringing the overall unionization rate in the U.S. economy to 10.1 percent. This unionization rate is an all-time low, down from nearly a third of all workers belonging to a union at the peak of union power in the 1950s. This low rate of unionization means that most workers have never and will never belong to a union.

The decline in the unionization rate is the result of a combination of policy, business, and economic changes. State legislatures passed "right to work" laws, while the Federal government weakened national collective bargaining rules. Manufacturers shifted operations to "right to work" states and out of the country. And the economy through these decades grew primarily in the service sector, in industries that have not traditionally been the focus of unions.

On the other hand, Americans' approval of labor unions remains near highs last seen in the mid-1960s after rising sharply from an all-time low in 2009.[103] Attitudes have shifted more favorably toward unions: 61% of Americans say that unions help the overall economy higher than at any other recorded time.[104] And when it comes to strikes, Americans tend to side with the workers. An August 2023 poll found that 3 out of 4 people side with the auto workers and more recent instant polls show continued strong support.

While some have argued that striking is indicative of high bargaining power, these labor actions are better described as the result of a rapidly changing economy in which there is a high degree of uncertainty. Over the past three years the labor market has gone through an extraordinary amount of upheaval. The number of people voluntarily leaving jobs and the number of people being hired each month has been above pre-pandemic levels for most of the past three years.

The ratio of the number of unemployed people to job openings has been elevated, but because most people taking open jobs are employed people trying to find a better job, this ratio is only useful in comparison to the past. Labor force participation has expanded more than most predicted and more people have changed jobs than in recent decades. The result is that this metric has provided almost no insight into how tight the labor market is in recent years. It surged as we recovered from the pandemic peaking in early 2022.

[101] https://www.ilr.cornell.edu/faculty-and-research/labor-action-tracker-2022 and https://www.bls.gov/wsp/.

[102] https://www.bls.gov/news.release/union2.t02.htm.

[103] https://news.gallup.com/poll/398303/approval-labor-unions-highest-point-1965.aspx.

[104] https://news.gallup.com/poll/510281/unions-strengthening.aspx.

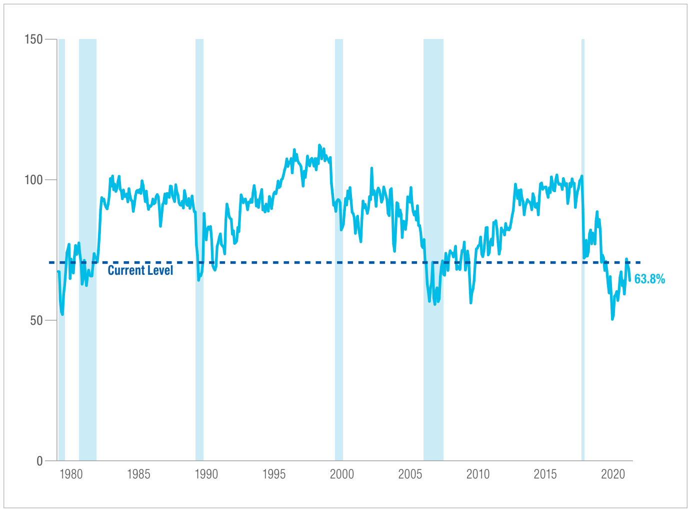
It has fallen substantially since then with little impact on unemployment or wages.

Low Consumer Sentiment

Americans are down on the U.S. economy, despite all of the economic good news. The Michigan survey of consumer confidence hit a low below that experienced at any point during the 2008 recession. It remains at levels typically only seen during recessions.

Figure 4: Consumer Confidence is at Recessionary Levels

University of Michigan consumer confidence index



Shaded areas show recessions.
Chart: @BetseyStevenson Source: University of Michigan. Created with Datawrapper.

Low consumer confidence combined with record high consumption spending has made consumer confidence a less useful metric of the state of the economy. Why are consumers spending so much if they are so down about the economy? Alternatively, why are consumers so down about the economy when they feel so confident to spend? One answer might be in the government support that was provided during the pandemic. Because consumers had excess savings they have been able to spend despite very real doubts about the strength of the economy.

Figure 5: Consumption Spending Remains Remarkably Strong (and Above the Pre-pandemic Trend)

Per capita consumption spending adjusted for inflation

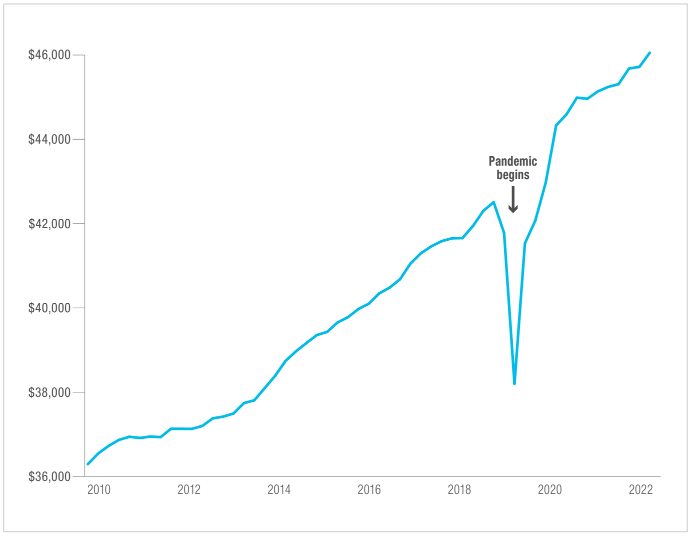


Chart: @BetseyStevenson. Source: Bureau of Economic Analysis. Created with Datawrapper.

Alternatively, this may simply be about money illusion. The income increases are letting them keep spending. Inflation is now down enough that there are no longer large redistributional impacts.

Bob Shiller found that people think that inflation impacts prices, making them worse off, but has little impact on their wages.[105] As he noted "people do not see the connection between inflation and increases in income that might be associated with it." This kind of selective credit leads people to really hate inflation. It is arguably worse right now because inflation has inflated the price of assets like homes and the stock market. Yet, homeowners rarely blame inflation for the higher value of their homes and shareholders rarely blame inflation for the higher nominal values of their investment portfolios.

The result is that people struggle to get over price increases. A 2023 Gallup poll found that 35% of respondents said that inflation and the high cost of living was the most important

[105] Shiller, Robert J. "Why Do People Dislike Inflation?" in Christina D. Romer and David H. Romer, eds., Reducing Inflation: Motivation and Strategy. Chap. 1. Chicago: University of Chicago Press, 1997, pp. 13-65.

financial problem that their family is facing. That compares to 6% of respondents in 2019. Even though the prices of many of the things households buy–like groceries–are largely unchanged from the beginning of 2023.

To be clear, the challenge is no longer inflation. While inflation remains above the Federal Reserve Board's target of 2 percent, the inflation rate is currently within historical norms. The 2023 third quarter inflation rate of 3.57% is below that in the last two quarters of 2005, the first two quarters of 2006, all of 2008, and the third quarter of 2011. The goal is to get the inflation rate as measured by the Consumer Price Index down about another percentage point, so that it is around 2.5%. Could people really be that upset about the economy because prices are rising 3.6% instead of by 2.5%?

The goal of setting inflation at 2 percent is that it is low enough to grease the wheels of the economy without being high enough to be noticeable. The rate of inflation we faced in 2022 was definitely high enough to be noticeable. The question is whether people are still noticing inflation because 3.6% inflation is too high to ignore or because they have yet to adjust to the higher level of prices.

A different explanation is that people are not angry about the economy right now, but instead they are angry about the economy of the 21st century. An economy that they see as unjust and rigged, serving a corrupt few at the expense of hard-working families. This sense that our economy is broken has contributed to our political polarization. The polling data show that Republicans are the most unhappy with the economy right now, even among those who say that their own economic situation is strong.

Some economists argue that it is the polls themselves that are broken. But I'm not so sure. Perhaps the polls are telling us something deeper about the broken trust people have in our institutions including the economy and our policy makers. People have been through the wringer over the past four years, and we came out of it with a better economy than when we entered it. But we entered with an economy that had stagnant wages for the middle class, unaffordable education and childcare, no guaranteed paid time off, and five decades of rising inequality.

Concluding Thoughts

This economic recovery has unique challenges from supply chain disruptions to a near-energy crisis related to Russia's invasion of Ukraine, to a war in the Middle East. But to put it in perspective, it took more than eight years for unemployment to fall below 4% following the 2008 recession. And yet, unemployment was below 4% by December 2021 less than two years following the pandemic-induced recession. Real GDP recovered to its 2019 fourth quarter level by the middle of 2021 and has exceeded most estimates of potential GDP for 2023.

The explanation for the ongoing strong recovery must lie with supply. Early in the pandemic, it was clear that worker illness and death, lower labor force participation, supply chain disruptions, and lower business investment had lowered potential GDP.[106] The question was how quickly it would recover. The answer is that the supply chain disruptions were temporary and have passed. Businesses became incredibly adaptable, with record high new business formation and rapid changes in how and where work is done.

[106] Fernald, J., & Li, H. (2021). *The Impact of COVID on Potential Output.* Federal Reserve Bank of San Francisco Working Paper 2021-09. https://doi.org/10.24148/wp2021-09; Furman, J., & Powell, W. (2022, January 27). *The economy grew faster than expected in 2021, but the pandemic transformed its composition.* Peterson Institute for International Economics. https://www.piie.com/blogs/realtime-economic-issues-watch/us-economy-grew-faster-expected-2021-pandemic-transformed-its.

It is too soon to do a post-mortem analysis of the fiscal and monetary policy response to the pandemic and its aftermath. While inflation has fallen from 9 percent to 3 percent, the final stages of reducing inflation to the Federal Reserve Board's target of 2 percent could prove particularly challenging. Yet, at this point it is clear that the economic recovery was initially (and perhaps too strongly) fueled by record high government spending. The fears that workers would be kept out of the labor force by unemployment insurance that completely replaced wages proved to be, if anything, temporary. Labor force participation in 2023 was higher for many groups of workers than it was in 2019. The many government programs that reduced debt and provided income to households allowed a demand-fueled recovery.

A year ago it was clear that GDP had fully recovered, but employment was still lagging pre-existing trends. The past 12 months of strong and unexpected labor growth has led to labor force participation rates that have surpassed the pre-existing levels of participation and are nearing the growth trends seen between 2015 and 2019. Low unemployment and rising labor force participation has happened in a labor market undergoing an extraordinary amount of upheaval.

All of the dynamism in the U.S. economy suggests a robust economy, but the changes of the past fifty years continue to drag on consumer sentiment and ultimately on the potential for the overall economy. Despite record high job growth, rising real wages, historic increases in wealth throughout the income distribution, and low debt burden, most Americans think that they are financially worse off. One poll found that only 14% of US voters believe that they are better off than they were in 2020 (before Joe Biden became President).[107]

A year ago *Foreign Policy* called for leaders at Davos to "start taking the public's declining faith in institutions seriously–or face more upheaval to come." This ominous warning came from decades of declining trust in institutions and interpersonal trust that has fostered partisanship, protests, and uprisings. *Foreign Policy* linked the discontent to the continued spread of populism, anti-capitalist sentiment, and the backlash against trade. They cited survey findings from the Edelman Trust Barometer, which surveys people across 28 countries and found that less than 20 percent of people trust the current system and 73 percent supported a change in the current system of global capitalism.

Trust is intricately linked to economic development–both facilitating economic growth and being shaped by economic growth. Higher trust in institutions leads to greater investment and economic activity because when people trust institutions to be effective, honest, and accountable, they are more likely to make long-term investments and engage in cooperative behavior. When governments are seen to be "exclusive" or "exploitative", perhaps due to an unequal distribution of power, economic stagnation or decline occurs.

Our current economy illustrates both how we can create a more inclusive economy and the need to do so in a way that builds public trust and cohesion. While much of the consumer anger sparked in the past year may be focused on high prices, its roots go deeper into our economic system. To succeed in the coming decades we will need to address the big challenges presented by global warming, rapid technological change, and an aging population in advanced economies. These problems will be impossible to address without rebuilding trust and confidence in government and the economy.

[107] https://www.ft.com/content/c17c35a3-e030-4e3b-9f49-c6bdf7d3da7f.

The State of Democratic Capitalism: 2023

AN ESSAY BY MICHAEL STRAIN (SEPTEMBER 2023)

How to assess the health of democratic capitalism in the United States? Fundamentally, it is very strong. The marriage of democratic politics and a free-market economy continues to strengthen each, with free markets generating the employment opportunities and prosperity that lead to widespread support for our political system and the rule of law, strengthen democratic legitimacy, and allow for relative social cohesion and harmony. And the U.S. political system has retained its fundamental commitment to free people and free markets, allowing the free enterprise system to allocate scarce resources and to foster an environment that allows for the creativity and innovation that drive long-term prosperity.

But there are dark clouds. The proper relationship between the state and the market has taken a few steps backward in recent years—and I am concerned about that trend accelerating, not reversing, given the similarities between the economic policies of the Biden and Trump administrations.

The Dark Clouds of Populism and Economic Nationalism

The United States has been living through an era of populism since the 2008 global financial crisis and Great Recession. This trauma shook democratic politics, it shook the free market—and it shook the marriage between the two.

The Great Recession was so severe that it took until 2014—six years after the financial crisis—for the median inflation-adjusted wages to return to its level in 2007 level. For six years, over half of workers lost ground.

It is no surprise that this experience led President Obama to declare that inequality is the defining issue of our time. It is no surprise that this experience led to Occupy Wall Street on the left and to a rise in hostility towards foreigners, immigrants, and racial and religious minorities on the right. It is no surprise that this experience led to a surge of populism in both parties, with Bernie Sanders and Donald Trump rising in prominence, influence, and power.

Populism is characterized by a pitting of "the people" against "the elites"—a lens for viewing society that fell on particularly fertile ground in the years following the global financial crisis. It is also characterized by pessimism about current and future economic outcomes for "the people." Populism indulges a narrative of victimhood and grievance, telling workers and households that they are not responsible for their economic circumstances. In the populist view, the elite is conspiring to keep its foot on the back of the people and the elite is so powerful that it cannot be stopped without, in the most extreme case, an authoritarian strongman or, at a minimum, a qualitatively more powerful and interventionist government.

This populist view is incorrect: I demonstrate in my book, *The American Dream Is Not Dead: (But Populism Could Kill It)*, that over the longer term our economic system is not rigged against workers and households, that hard work does pay off, that a rising tide does lift all boats, that wages and incomes have not been stagnant for decades, that the middle of the labor market has not been permanently hollowed out, and that America is still an upwardly mobile society. But the

Great Recession was so severe and long-lasting and affected so many that the populist message took root.

Against this backdrop, Donald Trump took office as president in 2017 with a more interventionist and less responsible approach to economic policy than would have been imaginable for a Republican president just a few years before. Mr. Trump abandoned the Republican Party's traditional commitment to free trade, launching a trade war against China. He imposed tariffs on allied nations. He abandoned the Republican Party's traditional commitment to reducing future spending on Medicare and Social Security, declaring those programs off limits to budget cuts. He demonized immigrants and attempted to slash immigration levels.

Disappointingly—and perhaps surprisingly—President Biden has followed his predecessor's lead on some (but not all) of those issues. The China tariffs remain in place despite four-decade-high consumer price inflation. President Biden's March 2021 COVID-19 relief bill—named the American Rescue Plan—was multiple times the size that was needed to support the economy. By stimulating consumer demand for goods and services to such a large degree when the economy was already in reasonable shape, the American Rescue Plan was one of the main factors behind the historic inflation that has been eroding the purchasing power of workers' wages and sentiment about the health of the economy. Its enactment was the most reckless fiscal policy decision in decades.

Just as Mr. Trump moved the Republican Party to adopt the Democratic Party's traditional opposition to cutting future spending on Medicare and Social Security, President Biden has adopted much of the Republican Party's opposition to tax increases. The President has made clear that he will not increase taxes on households earning less than $400,000 per year. So we now have bipartisan agreement in the U.S. not to increase taxes on the bottom 98 percent of households.

The President has surprised supporters by the degree to which he has been unwilling to embrace a return to normal immigration levels. And President Biden is an unabashed champion of industrial policy, signing into law hundreds of billions of dollars of subsidies and incentives for domestic clean-energy and semiconductor manufacturing.

All of this represents bad economic policy that will dampen gains in long-term prosperity. Protectionism and industrial policy fail to achieve their goals in part because the government lacks the scope and scale of authority needed to make them succeed. Trade policy designed to protect U.S. workers from import competition might work if the U.S. government could prevent other nations from retaliating. But it can't. Because Mr. Trump's trade war spurred retaliatory actions by other nations—and because it make it more expensive for U.S. businesses to import goods—it cost the U.S. manufacturing jobs while raising consumer prices.

President Biden's industrial policy will suffer a similar fate. The President can authorize subsidies for semiconductor manufacturing, but he can't quickly create a U.S. workforce capable of actually manufacturing semiconductors. At the time of this writing, that industry is unable to find enough workers to take full advantage of the government's subsidies. As with the Trump trade war, President Biden's clean-energy subsidy scheme threatens to launch a subsidy war, with South Korea and European nations responding with their own subsidies. Tit-for-tat industrial policy blunts the impact of any one nation's subsidies, leading the policy to fail on its own terms. Moreover, it reduces economic efficiency by having the government allocate scarce economic resources according to political whims and not based on the best use of those resources. Over the longer term, productivity growth will suffer, along with wage and income growth.

Similarly, failing to address the nation's long-term fiscal imbalance (through a combination of cuts to projected spending on Social Security and health programs and increases in tax revenue) threatens economic growth, wage growth, and higher living standards by reducing investment and dampening productivity growth. Higher debt levels must be serviced, and growing interest payments on the debt crowd out political space for investments in basic research and infrastructure, hurting the outlook for innovation.

Though neither President Biden nor President Trump are great champions of immigration, there is no equivalence between the two on this issue. The populism and nationalism of Mr. Trump effectively hung a sign on the Statue of Liberty saying: "Immigrants aren't welcome here." Sending that signal—to say nothing of demonizing immigrants, as Mr. Trump and his followers routinely do—is an act of economic self-sabotage. The United States should celebrate and jealously guard its role as a destination for some of the hardest working, most innovative, most risk tolerant, and most entrepreneurial people born abroad.

So all this is bad policy, yes. It also marks an unhealthy turn for democratic capitalism in the United States. In the case of protectionism and industrial policy, it marks a willingness by leaders of both political parties to intervene in the market in order to advance political objectives much more aggressively than has been the case in recent decades. That these policies likely will not succeed as judged against their own goals is an important offense against the spirit of democratic capitalism: government intervention in markets should achieve the goals set out by the political system.

But the offense runs deeper. For democratic capitalism to be at its most healthy, government intervention should be motivated by a desire to address a market failure, correct an externality, advance economic opportunity for vulnerable members of society, or for a similarly important reason. But the reasons to prioritize domestic manufacturing given by elected leaders fall short of this basic standard. Even the oft-invoked national security rationale collapses under scrutiny: Yes, it does not make sense for components of critical weapons systems to be manufactured in China, an increasingly adversarial nation. But why does that manufacturing activity need to be located in a 2024 U.S. swing state? Why not, say, Mexico or Vietnam?

Similarly, the bipartisan agreement not to address the nation's fiscal imbalance or to address the economic need for increases in immigration levels are a blight on the compact between democratic politics and free-market capitalism. In that deal, markets generate jobs and incomes sufficient for democracy's continued legitimacy. Absent increases in immigration levels, longer-term economic growth is at risk due to a tepid outlook for labor force growth. The national debt is a general threat to long-term prosperity and a specific threat to the most vulnerable members of society who rely on Social Security and government health programs, whose benefits could be cut abruptly unless deliberate, foresighted policy is enacted to curb their overall future expenditures.

On a fundamental level, populism disempowers people by telling them that they are helpless victims of a powerful elite. Because populism tells people that they don't have agency—they aren't empowered to better their circumstances—it undermines the success of free-market capitalism, which depends on people working hard, aspiring, innovating, and taking risks. Populism opens the door to a larger role for government intervention in markets, both because it weakens political support for markets and because it makes people think that they need intervention to better their outcomes to a greater extent than is empirically supported.

In this way, economic nationalism flows directly from populism. And populism becomes not just a threat to economic liberty, but to political liberty as well: As the role of the state in economic affairs grows, the ability of free markets to serve as a check on politics erodes. And the larger the role of the state in economic affairs, the smaller the role for voluntary cooperation among society as a whole. The voluntary nature of participation in free markets is itself a bulwark against political tyranny and authoritarianism. Populism and nationalism aren't just a threat to free markets, they are a threat to democracy as well. To ensure that our voluntary choices in the ballot box are respected, we must ensure that our voluntary choices in the marketplace are respected.

The State of Market Competition

The rise of populism has led to increasing suspicion of big business. In many quarters—including, on the political left, the White House, and leaders at the Federal Trade Commission and Department of Justice; and, on the political right, economic nationalists and social conservatives—large corporations are increasing looked at with suspicion simply because of their size. In an economic context, "bigness" is considered potentially problematic because it might snuff out competitors, disadvantaging smaller firms and new firms. In the context of democratic capitalism, "bigness" is looked upon with suspicion because political power is assumed to flow from political power.

These concerns are not wholly unreasonable. The government should be ensuring that markets are competitive, and it can reasonably be argued that in recent decades enforcement has been too lax.

But the approach of current government leaders is completely off base and would set competition policy back half a century if successful. It would switch the baseline standard against which the level of competition in a market is measured. The "big is bad" standard judges competition by the size of the most dominant firms. The consumer welfare standard, in contrast, focuses on whether a market is producing low-cost, high-quality goods and services and is characterized by innovation and dynamism.

To put it another way, here are two possible questions regulators could ask: (1) "Are firms in a market competing to deliver goods and services to consumers at the lowest cost possible, with sufficient quality and variety?" (2) "Are firms in a market 'too big and too powerful'?" For the past half century, the United States government has asked the first question, not the second. In my view, the first question is clearly the right question regulators should be asking.

Big firms can offer benefits to consumers that small firms can't. For some firms, the cost of production decreases as the quantity of output it produces increases. Producing higher quantities of output—what happens when a firm gets bigger, or is "big"—can allow for workers to be increasingly specialized in the tasks they perform. Because of its relatively large size, workers at the firm are more productive and the firm is more efficient. Similarly, a firm can produce higher quantities of output by increasing the variety or types of goods or services it offers, which can create similar productivity and efficiency gains. Among social media companies, larger networks can bring substantial consumer benefits. At the same time, firms can clearly be "too big." For example, increasing size can bring with it coordination problems among workers and monitoring problems among managers that reduces productivity and lead to less efficient production.

This ambiguity—sometimes bigger is better, sometimes bigger is worse—implies that market concentration in and of itself should not be used as a standard against which to judge whether a market is competitive. Breaking up a company that is big could hurt, not help, consumers. It could make a market less, not more, competitive. Moreover, because this standard is so ambiguous, it invites regulatory mischief and unduly politicizes antitrust enforcement.

Instead, the consumer welfare standard judges whether firms are competing with sufficient intensity by focusing on outcomes for consumers: If firms are competing, then prices should be low, quality should be high, variety should be plentiful, and innovative activity should be present.

A more subtle concern is whether today's large companies are stifling tomorrow's market competition. This concern has been raised about tech companies acquiring startups which might otherwise grow into competitors. It is reasonable to be concerned that these types of acquisitions could stifle competition. But if they stifled future competition, then they would run afoul of the consumer welfare standard. This concern is no reason to abandon the consumer welfare standard for a "big is bad" standard.

Moreover, some of the companies attracting the most attention from regulators plow money into research and development—behavior you wouldn't expect if they viewed themselves entrenched monopolies safe from competitors. In addition, many of those startups have the goal of being acquired—the presence of large tech firms that are interested in acquiring startups could increase, rather than decrease, the type of innovation that benefits consumers and makes markets more competitive.

And the concern that some tech companies are entrenched is refuted by history. Netscape was once viewed this way, but it fell to Internet Explorer, which in turn fell to Google Chrome. America Online's Instant Messenger service was once considered entrenched. Hotmail was displaced by Gmail. MySpace was considered by many to be entrenched because of its network effects, but it fell and Facebook ascended. Today, Facebook is losing market share among younger Americans. In 2007, Forbes magazine declared that "no mobile company will ever know more about how people use phones than Nokia." On June 29th of that year Apple released the iPhone. Many of the same concerns voiced today about Amazon's dominance in consumer product markets were voiced about Walmart in the recent past. And despite the impression given by the public debate, Walmart is still a larger company than Amazon.

With respect to democratic capitalism, many are asking whether today's social media companies are a threat to democracy by controlling access to information. Hardly. It was not long ago that the typical American's access to news was limited to three nightly news broadcast, the morning newspaper, and some weekly magazines. In part because of tech companies, Americans today have access to an avalanche of information. This is not to say that additional regulation about speech on these platforms should not be considered. But using antitrust powers to break them up over concerns about their role in the public square is absurd. A more reasonable concern is that the massive increase in information sources has led to viewpoint specialization, allowing Americans to find echo chambers and limiting their exposure to other views. This is certainly a problem for the health of democracy, but it is not a problem that antitrust regulators should attempt to solve.

Indeed, breaking up these companies out of concern for the health of democracy would represent a dramatic imbalance in the appropriate relationship between the market and the state. And changing the standard by which market competition is judged from the welfare of consumers to a "big is bad" standard would be a threat to the health of democratic capitalism by allowing political goals to inappropriate infringe on market outcomes—an infringement that would leave consumers worse off.

Democratic Capitalism and the Economic Outlook

The economy is still suffering from the fiscal policy mistakes of 2021. That year, the American Rescue Plan stimulated consumer's demand for goods and services well in excess of the economy's productive capacity. When too much demand met inadequate supply, prices increased. Price inflation has been so severe that despite an extremely strong labor market the inflation-adjusted average worker's wage is below its pre-pandemic trend. Inflation-adjusted average personal income was lower in 2022 than in 2019, 2020, or 2021. Inflation-adjusted median household income was also lower in 2022 than in 2019, 2020, or 2021.

In addition to eroding the purchasing power of workers' wages and household income, at the time of this writing I still expect that putting price inflation on a path to the Federal Reserve's inflation target will require a mild recession. In that event, many of the positive effects of the President's stimulus—including an extremely strong labor market—will have been partially undone, adding higher unemployment to the costs of the stimulus.

Given high inflation and its effect on the purchasing power of wages and incomes, it should be no surprise that President Biden's approval rating on the economy is very low. With the 2021 stimulus law, the President prioritized his political and policy goals ahead of economic fundamentals. This was not the only reason the U.S. economy has experienced four-decade-high inflation, of course. But it was a major contributing factor to this inflationary episode. It juiced prices and represented an unhealthy imbalance in the proper relationship between the economy and politics.

Optimism

Fundamentally, the state of democratic capitalism in 2023 is strong. But it has weakened considerably in the past seven years. Populism and nationalism have made substantial inroads in both political parties. And it is more likely than not that President Trump or President Biden will be sworn into office for another term after the 2024 election, potentially prolonging this harmful turn in economic policy. Neither president seems to understand the proper relationship between democratic politics and free markets—or the proper balance between the two that will ensure the best outcomes in both spheres over the long run.

Still, I am a long-term optimist about democratic capitalism in the United States. The populist storm clouds will scatter as the economy—which is fundamentally strong and well balanced—moves past this business cycle and can enjoy a few years of solid, real wage growth. Ultimately, enduring political success must rest on a foundation of policy success. The populist and nationalist diagnosis of America's economic problems is wrong. Their solutions won't work. That economic reality will lead to a political course correction. The future for democratic capitalism is bright.

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Suggested Readings

Chang, Ha-Joon. *23 Things They Don't Tell You about Capitalism.* Penguin Books, 2011.

Ferguson, Niall. *The Great Degeneration: How Institutions Decay and Economies Die.* Penguin Books, 2014.

Coates, John. *The Problem of 12: When a Few Financial Institutions Control Everything.* Columbia Global Reports, 2023.

Friedman, Milton. *Capitalism and Freedom.* University of Chicago Press, 2020.

Liu, Glory M. *Adam Smith's America: How a Scottish Philosopher Became an Icon of American Capitalism.* Princeton University Press, 2022.

Gramm, Phil, et al. *The Myth of American Inequality the Myth of American Inequality: How Government Biases Policy Debate.* Rowman & Littlefield, 2022.

Otteson, James R. *Honorable Business: A Framework for Business in a Just and Humane Society.* Oxford University Press, 2019.

Philippon, Thomas. *The Great Reversal: How America Gave up on Free Markets.* Harvard University Press, 2019.

Wolf, Martin. *The Crisis of Democratic Capitalism the Crisis of Democratic Capitalism.* Penguin Press, 2023.

Addendum | Industrial Policy: Proceed with Caution

A "MODERN INDUSTRIAL STRATEGY"

On October 13, 2022, Brian Deese, Director of President Biden's National Economic Council, declared that it was time for America to embrace a modern industrial strategy: "At its core, the idea is a simple one: strategic public investments are essential to achieving the full potential of our nation's economy."[110] To support his case, Mr. Deese referenced the construction of the Erie Canal and President Lincoln's empowerment of states to use federal lands to establish land grant colleges including the Ohio State University, emphasizing how these developments drove future private commerce and innovation.

To amplify Mr. Deese's point, the strategic public investments he references are ambitious in scope and size. President Biden's industrial policy is comprised primarily of three recent acts of legislation: (1) the Bipartisan Infrastructure Law (2021), (2) the CHIPs and Science Act (2022), and (3) the Inflation Reduction Act (2022). McKinsey estimates that, taken together, the acts introduce approximately $2 trillion in government spending over the next 10 years.[111] The policies will utilize subsidies, tax incentives, and direct investments with the following objectives: improving transportation and other core infrastructure, increasing U.S. semiconductor manufacturing capacity, creating high-tech hubs and a more inclusive STEM workforce, addressing healthcare delivery efficiency and costs, encouraging clean energy investments, and bolstering IRS staffing and taxpayer compliance.

INTRODUCING INDUSTRIAL POLICY

The rationale for these acts and policies like them is a belief that the market economy, left to its own, sometimes produces undesirable outcomes, i.e., either not addressing certain important issues at all or not addressing them quickly enough. Why does the market's system of profit sometimes miss the mark in determining which businesses and/or industries survive and which fail? In what cases would government interventions steer markets in better directions?

"These then are the basic roles of government in a free society: to provide a means whereby we can modify the rules, to mediate differences among us on the meaning of the rules, and to enforce compliance with the rules on the part of those few who would otherwise not play the game."[108]

Milton Friedman
University of Chicago

"In a community situated like that of the United States, the public purse must supply the deficiency of private resource. In what can it be so useful as in prompting and improving the efforts of industry?"[109]

Alexander Hamilton
First Secretary of the Treasury

[108] Friedman, Milton, *Capitalism & Freedom,* The University of Chicago Press, 1962, p. 25.
[109] Hamilton, Alexander, *Report of the Secretary of the Treasury of the United States on the Subject of Manufactures,* 1791, p. 58.
[110] Deese, Brian, *Remarks on Executing a Modern Industrial Strategy,* City Club of Cleveland, October 13, 2022.
[111] Badlam, J., et al. "The Inflation Reduction Act: Here's what's in it." *McKinsey Public Sector Practice* (2022).

If industrial policy is distinct from macroeconomic policy (e.g., monetary policy set by the Federal Reserve), what exactly is it? *Industrial policy is the steering of market outcomes by government actions when people don't approve of the outcomes produced by the market and its profit-and-loss incentives.*[112] Government interventions can take on many forms, including direct investment, taxes, subsidies, mandates, and tariffs. For example, electric vehicles (EVs) carry higher price tags than their gasoline and diesel-powered counterparts, and so the federal government offers consumers a substantial price subsidy to motivate consumers to buy EVs in higher volumes and more quickly than the market could deliver EVs at comparable net prices. This subsidy is intended to encourage consumers and the market to prioritize EVs as a more environmentally sustainable option that can help lower carbon emissions as well as compete with cheaper Chinese competitors. The EV subsidy is not only an example of a current industrial policy in the U.S. but also a reminder that industrial policy steers market outcomes in pursuit of larger societal goals. In the case of EVs, the policies focus on environmental concerns and strengthening U.S. industries against foreign competition but industrial policy can also center around issues such as health and consumer safety, labor conditions, domestic competition, and national security interests.

IMPERFECTIONS: PLENTY TO GO AROUND

If profit and loss is the key element to the market's decision making, one must ask what drives confidence in industrial policy to improve upon market results. The key beliefs that provide support for industrial policy are: (1) that markets are imperfect, (2) that government experts know what the right outcomes are, and (3) that politicians are motivated to design policies to produce those outcomes. As markets have imperfections, don't experts and politicians have them as well?

When considering industrial policy, it is important to consider the risks and benefits of both markets and government intervention. As Duke University economist and political scientist Michael Munger put it, "the best argument for markets is not the perfection of the price mechanism; it's the imperfection of the world."[113] William Galston, a Brookings Institution scholar and former advisor to President Clinton on domestic policy, agrees:

"Everything made by human beings is imperfect in one way or another. That goes for government, and it goes for markets. There are government failures, and there are market failures. And prudence and judgment are needed in order to discern which failure is the graver threat to the common good at any particular point in our history."[114]

[112] This definition is based on one given on a podcast, "EconTalk: Michael Munger on Industrial Policy", October 31, 2022, accessed August 27, 2023.
[113] Munger, Michael, I*s Capitalism Sustainable?,* American Institute for Economic Research, 2019, p. 223.
[114] Galston, William, as quoted in CNN Transcript from "Beyond the Politics", October 11, 2008.

The Case to Beat

Earlier this year, *The Economist* offered its views on the subject, observing at the outset that "industrial policy is just about as old as industry itself."[118] The article highlights the potential for industrial policy successes in the limited context of infant-industry settings where a lack of know-how, specialized equipment, and skilled labor might hold back an absent or nascent industry that could otherwise thrive. Cambridge economist Ha-Joon Chang rightly reminds us that if we believe that "only winner-picking by the private sector can succeed, we will end up ignoring [...] possibilities for economic development through public leadership or public-private joint efforts."[119]

In a similar vein, University College London professor Mariana Mazzucato argues for the potential of public leadership in driving innovation through investing in early and high-risk research and technologies.[120] In addition to the possibilities of public-private partnership and public leadership driving innovation and growth within the private sector, there is also potential for public sector services to compete with the private sector, which

CASE STUDY: ELECTRIC VEHICLES

Electric Vehicles (EV) provide an example of how industrial policy may aim at a noble social objective, the reduction of fossil fuel emissions from passenger vehicles, but can still fall short of such goals. Consider the following flaws in the policies that attempt to correct market imperfections:

- EVs, once their batteries are charged, do transport people from place to place with zero emissions, but when the entire EV supply chain and the source of the power needed to charge the EV is considered, the environmental benefits of electric vehicles are greatly reduced.[115] Additionally, EV subsidies prioritize electric vehicles over other transportation solutions that could reduce emissions such as mass transit like buses or train systems or bike lanes.

- The reluctance of lawmakers to sunset old policies to make room for new policies also complicates the picture. New policies around EVs and higher fuel efficiency for gas-powered vehicles are layered on old policies that have been left untouched. U.S. automakers can leverage 1960s-era import tariffs on pick-up trucks and large SUVs—and carve outs for these large vehicles in fuel efficiency mandates—to sell the more profitable, low efficiency vehicles to offset the losses they are incurring on EVs and higher efficiency models.[116] These older policies undercut the environmental goals of the EV subsidies.

- In the most recent publication of The Federal Register, the National Highway Transportation Safety Board concludes that Department of Transportation fuel efficiency mandates for passenger cars (also known as CAFE standards) will actually harm overall private welfare over the life of the higher gas-mileage-rated cars. In fact, increasing passenger car CAFE standards by 2% each year will reduce private welfare by $5.8 billion.[117]

[115] To get a complete picture of the environmental impact of an EV, one must include the impacts of: (a) mining the materials needed to make the battery, (b) the manufacturing and eventual disposal of the battery, and (c) the source of the electricity used to charge the battery. While many studies still predict an overall benefit, others are overly optimistic because they ignore one or more parts of the EV supply chain. Even if EVs offer environmental benefits, it's another question altogether on whether government investments will pay dividends.

[116] *The Wall Street Journal,* August 26, 2023.

[117] "Corporate Average Fuel Economy Standards for Passenger Cars and Light Trucks for Model Years 2027-2032 and Fuel Efficiency Standards for Heavy-Duty Pickup Trucks and Vans for Model Years 2030-2035", The Federal Register, as referenced by *The Wall Street Journal,* August 23, 2023. NHTSA's definition of private welfare attempts to include all aspects of car ownership, i.e., fuel cost savings and health benefits of cleaner air—weighed against higher risks of injury due to lower weight car construction, higher repair costs for average accidents.

[118] "Warnings from History for a New Era of Industrial Policy", *The Economist,* January 11, 2023.

[119] For an example of industrial policy producing desired results, see Cambridge economist Ha-Joon Chang's account of the development of South Korea's economy in his book *23 Things They Don't Tell You About Capitalism,* Penguin Books, 2011, pp. 125-136.

[120] Mazzucato, M. *The Entrepreneurial State: Debunking Public vs. Private Sector Myths.* 2015.

can generate positive impacts on the quality and cost of both private and government services.[121] There are many ways that industrial policy can be used to benefit American consumers, the economy overall, and the private sector.

However, *The Economist's* editors still advise policy makers "to proceed with caution" because interventions can have "unintended consequences, raising costs and hurting consumers."[122] One additional downside is the potential loss of taxpayer funds invested in a technology or industry that doesn't succeed—and unlike private investors and shareholders, individual taxpayers don't have a direct say in the investment decision. If a market player makes a bad investment decision, that player will suffer losses and think twice before heading down the same path again; on the other hand, there is little, if any, correlation among politicians voting for misguided industrial policy and their odds of winning the next election.

Voters should encourage their representatives to think long and hard about government interventions beyond the basic functions, and if they want to move forward on major legislation, at least test the ideas on a small scale before enacting $10 billion worth of policy-driven investments.

If we can agree that markets, experts, and politicians all suffer from imperfect systems and motivations, perhaps future policymakers can approach new industrial policy ideas with greater caution, and with added doses of reality and humility.

"To say that government can improve on market outcomes at times does not mean that it always will. Public policy is made not by angels but by a political process that is far from perfect. Sometimes policies are made to reward the politically powerful. Sometimes they are made by well-intentioned leaders who are not fully informed."[123]

N. Gregory Mankiw
Harvard University

[121] Schnurer, E. "When Government Competes against the Private Sector Everybody Wins." *The Atlantic,* March 11, 2015.
[122] Ibid.
[123] Mankiw, N. Gregory. *Principles of Economics,* Seventh Edition. Thomson/South-Western, 2013, p. 12.

Attachment A: 2022 Inaugural Report Initial Findings

In the Vital Statistics section of the 2022 Inaugural Report, we organized the datasets and accompanying descriptions into five categories: (1) efficacy & vitality, (2) fairness & social mobility, (3) social well-being & stability, (4) business environment, and (5) international comparisons. The first four dataset groups focus on trends in the U.S., with the fifth group set aside for select international comparisons.

Below we summarize our findings by category:

- **Efficacy & vitality:** ***Does our economic system generate growing total wealth?*** The U.S. economic system continues to generate growing total wealth and to produce new innovations—but the rate of growth is slowing down, and inputs to GDP growth face potentially daunting headwinds. A significant long-term issue is the declining fertility rate in the developed world and its potential impact on the future working age population, assuming other factors that affect country-by-country working age population remain fairly stable.
- **Fairness & social mobility:** ***Does the system address the well-being of all members of society, or does it favor distinct groups?*** Despite recent economic shocks, the U.S. economy continues to provide jobs and a growing level of income for most members of society. However, the overall labor share of GDP is decreasing, income is growing more slowly for most workers than it is for the top earners, and upward mobility between generations has decreased significantly since the mid-twentieth century as more parents of college graduates are college graduates themselves.
- **Social well-being & stability:** ***How does the system strengthen (or weaken) society more broadly?*** In several ways, our economic system benefits society broadly: a smaller share of citizens live in poverty, Americans are attaining higher education levels than in the past, home ownership is on the rise, and CO_2 emissions per capita are decreasing. In contrast, life expectancy has stalled, the cost of education and level of student debt have grown, the public's views of business and capitalism are growing less favorable, trust in institutions has declined, and efforts to reduce emissions are widely considered to be insufficient to reduce the impacts of climate change.
- **Business environment:** ***What is the current status and nature of free market competition, and how well is the business community positioned to address current pressures on the system?*** Business sector concentration is increasing and in some sectors is threatening the essential beneficial effects of market competition. At the same time, businesses are investing less, paying out more in dividends, and repurchasing shares in record amounts. These trends may reflect a lack of long-term time horizons in business decision-making. Also, government regulatory spending continues to increase. In addition, more business leaders are ambitiously calling for "profits with a purpose" and publicly embracing the concept of stakeholder capitalism, though it's unclear what real follow-through looks like, and if/when it will happen at scale. In addition, a large percentage of shareholders have no voice in how the shares they own in equity funds are voted, which may distort the messages sent to boards by shareholders.

- **International comparisons:** ***How does the U.S. compare to other democratic economies, and what can we learn from the differences?*** Compared to other democratic economies, the U.S. is holding its own in terms of GDP growth, labor compensation as a share of GDP, reduction in CO_2 emissions per capita, and its citizens' views of their own well-being. However, the U.S. is losing ground when it comes to life expectancy, labor force participation even when jobs are available, income inequality (as measured by the Gini Coefficient), social mobility, and total emissions. On top of that, current U.S. government interventions have 30-50% less impact on the Gini measure of inequality than programs in other developed democratic economies which may not condition benefits on employment.

Key Questions for Paths Forward

The vital statistic datasets raise many more questions than the first installment of our annual report can address, but we highlight the following questions given their urgency and the long-term nature of likely solutions.

- Is future **overall GDP growth under threat** (i.e., shrinking fertility rates in the developed world undermining future working age population)? And if yes, what options exist to counteract the potential impact? Can other inputs change enough to help (immigration, worker productivity, technical innovation)? Might the shorter-term focus of a growing number of companies (often revealed by declining capital investment and increased share repurchases) also be a threat to future GDP growth?

- What are the **root causes of the growing gap in incomes,** and can they be addressed in a way that improves equity but does not discourage investment and innovation? For example, what can be done to reign in CEO compensation vis-a-vis average worker pay while keeping top-level talent engaged and motivated?

- What role has **globalization played in the lack of income growth** for the average U.S. worker? Is there a way to strengthen local communities by mitigating the globalization effects on U.S. workers without significant impact to overall productivity and efficiency?

- Why has **upward social mobility slowed** significantly in the U.S., and how can business, government, and society work together to reverse the trend? Are there examples of upward mobility improving in other settings, and if yes, what can we learn? Given the increase in college graduates across generations, are we measuring mobility correctly?

- Why are many business sectors becoming more concentrated, and is concentration leading to **lower quality market competition** that will ultimately undermine the market/society balance? Why has the number of public companies dropped by almost 50% over the last 25 years, and what might the consequences be? Are consistent increases in lobbying spending an indication that elements of crony capitalism are contributing to lower quality of competition?

- How can **corporations generate value for shareholders but also address the needs of the other stakeholders?** Are there value-creating rationales that can strengthen the purpose and profit movement? How can boards and management teams properly measure long-term benefits (and costs) of ESG initiatives? Should society expect something in return for providing corporate shareholders with limited liability? What steps can companies take to embrace a broader view of business's role in society that doesn't sacrifice profitability, innovation and investment? How can shareholders be persuaded to rethink their current high volume, autopilot-engagement with boards and companies?

Areas for Further Research

Democratic capitalism is under pressure, and we should not shy away from identifying problems that need to be addressed. Using data to better understand the problems within the system and identify potential solutions can help improve and strengthen both capitalism and democratic society.

At the same time, we should not let a clear-eyed acknowledgment of real problems cause us to forget the many benefits of free market capitalism. When combined with various forms of democratic societies built upon disciplined moral/cultural frameworks, the market economy continues to support human flourishing around the world.

Therefore, with the aim of reconciling the market economy's many benefits with society's values and needs, we recommend the following topics as areas that merit further research to (1) better define problem areas, (2) verify the existence and extent of problems and sub-issues, and (3) propose potential solutions.

- Threats to future overall **GDP growth**, including declining fertility rates and short-term corporate behaviors
- Root causes of the growing **gaps in incomes**
- Unintended **impacts of globalization** on local communities and workers
- Excessive levels of **executive compensation**
- Slowdown in **upward social mobility** outcomes
- Decreasing **quality of market competition** and apparent rise of **crony capitalism**
- **Increasing government regulatory budgets** and implications for business and lobby spending
- Lack of **value-creating rationales and tangible actions** for corporate boards and management teams that better integrate needs of all stakeholders in long-term strategy and which do not impair compensation fairness for employees or discourage investment by shareholders
- Missing incentives and common measurement protocols for collective **stewardship of natural resources** and/or rationale for **industry self-regulation**
- Inadequate attention to **society's quid pro quo** for corporate shareholder limited liability
- Apparent **concession by shareholders of the inherent right to vote shares** held by fiduciaries on their behalf

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