

undermines private enterprise and inhibits economic growth. The bankruptcy of communism and socialism as alternative means of economic organization has only reinforced this assumption. In our standard economics textbooks and in our modern political debates, *laissez-faire* is the default rule; anyone who would challenge it swims against the prevailing tide.

It's useful to remind ourselves, then, that our free-market system is the result neither of natural law nor of divine providence. Rather, it emerged through a painful process of trial and error, a series of difficult choices between efficiency and fairness, stability and change. And although the benefits of our free-market system have mostly derived from the individual efforts of generations of men and women pursuing their own vision of happiness, in each and every period of great economic upheaval and transition we've depended on government action to open up opportunity, encourage competition, and make the market work better.

In broad outline, government action has taken three forms. First, government has been called upon throughout our history to build the infrastructure, train the workforce, and otherwise lay the foundations necessary for economic growth. All the Founding Fathers recognized the connection between private property and liberty, but it was Alexander Hamilton who also recognized the vast potential of a national economy—one based not on America's agrarian past but on a commercial and industrial future. To realize this potential, Hamilton argued, America needed a strong and active national government, and as America's first Treasury secretary he set about putting his ideas to work. He nationalized the Revolutionary

War debt, which not only stitched together the economies of the individual states but helped spur a national system of credit and fluid capital markets. He promoted policies—from strong patent laws to high tariffs—to encourage American manufacturing, and proposed investment in roads and bridges needed to move products to market.

Hamilton encountered fierce resistance from Thomas Jefferson, who feared that a strong national government tied to wealthy commercial interests would undermine his vision of an egalitarian democracy tied to the land. But Hamilton understood that only through the liberation of capital from local landed interests could America tap into its most powerful resource—namely the energy and enterprise of the American people. This idea of social mobility constituted one of the great early bargains of American capitalism; industrial and commercial capitalism might lead to greater instability, but it would be a dynamic system in which anyone with enough energy and talent could rise to the top. And on this point, at least, Jefferson agreed—it was based on his belief in a meritocracy, rather than a hereditary aristocracy, that Jefferson would champion the creation of a national, government-financed university that could educate and train talent across the new nation, and that he considered the founding of the University of Virginia to be one of his greatest achievements.

This tradition, of government investment in America's physical infrastructure and in its people, was thoroughly embraced by Abraham Lincoln and the early Republican Party. For Lincoln, the essence of America was opportunity, the ability of "free labor" to advance in life. Lincoln considered capitalism the best means of creating such opportunity, but he also saw how the transition from an

agricultural to an industrial society was disrupting lives and destroying communities.

So in the midst of civil war, Lincoln embarked on a series of policies that not only laid the groundwork for a fully integrated national economy but extended the ladders of opportunity downward to reach more and more people. He pushed for the construction of the first transcontinental railroad. He incorporated the National Academy of Sciences, to spur basic research and scientific discovery that could lead to new technology and commercial applications. He passed the landmark Homestead Act of 1862, which turned over vast amounts of public land across the western United States to settlers from the East and immigrants from around the world, so that they, too, could claim a stake in the nation's growing economy. And then, rather than leave these homesteaders to fend for themselves, he created a system of land grant colleges to instruct farmers on the latest agricultural techniques, and to provide them the liberal education that would allow them to dream beyond the confines of life on the farm.

Hamilton's and Lincoln's basic insight—that the resources and power of the national government can facilitate, rather than supplant, a vibrant free market—has continued to be one of the cornerstones of both Republican and Democratic policies at every stage of America's development. The Hoover Dam, the Tennessee Valley Authority, the interstate highway system, the Internet, the Human Genome Project—time and again, government investment has helped pave the way for an explosion of private economic activity. And through the creation of a system of public schools and institutions of higher education, as well as programs like the GI Bill that made a

college education available to millions, government has helped provide individuals the tools to adapt and innovate in a climate of constant technological change.

Aside from making needed investments that private enterprise can't or won't make on its own, an active national government has also been indispensable in dealing with market failures—those recurring snags in any capitalist system that either inhibit the efficient workings of the market or result in harm to the public. Teddy Roosevelt recognized that monopoly power could restrict competition, and made “trust busting” a centerpiece of his administration. Woodrow Wilson instituted the Federal Reserve Bank, to manage the money supply and curb periodic panics in the financial markets. Federal and state governments established the first consumer laws—the Pure Food and Drug Act, the Meat Inspection Act—to protect Americans from harmful products.

But it was during the stock market crash of 1929 and the subsequent Depression that the government's vital role in regulating the marketplace became fully apparent. With investor confidence shattered, bank runs threatening the collapse of the financial system, and a downward spiral in consumer demand and business investment, FDR engineered a series of government interventions that arrested further economic contraction. For the next eight years, the New Deal administration experimented with policies to restart the economy, and although not all of these interventions produced their intended results, they did leave behind a regulatory structure that helps limit the risk of economic crisis: a Securities and Exchange Commission to ensure transparency in the financial markets and protect smaller investors from fraud and insider

manipulation; FDIC insurance to provide confidence to bank depositors; and countercyclical fiscal and monetary policies, whether in the form of tax cuts, increased liquidity, or direct government spending, to stimulate demand when business and consumers have pulled back from the market.

3 Finally—and most controversially—government has helped structure the social compact between business and the American worker. During America's first 150 years, as capital became more concentrated in trusts and limited liability corporations, workers were prevented by law and by violence from forming unions that would increase their own leverage. Workers had almost no protections from unsafe or inhumane working conditions, whether in sweatshops or meatpacking plants. Nor did American culture have much sympathy for workers left impoverished by capitalism's periodic gales of "creative destruction"—the recipe for individual success was greater toil, not pampering from the state. What safety net did exist came from the uneven and meager resources of private charity.

Again, it took the shock of the Great Depression, with a third of all people finding themselves out of work, ill housed, ill clothed, and ill fed, for government to correct this imbalance. Two years into office, FDR was able to push through Congress the Social Security Act of 1935, the centerpiece of the new welfare state, a safety net that would lift almost half of all senior citizens out of poverty, provide unemployment insurance for those who had lost their jobs, and provide modest welfare payments to the disabled and the elderly poor. FDR also initiated laws that fundamentally changed the relationship between capital and labor: the forty-hour workweek, child labor laws, and minimum wage

laws; and the National Labor Relations Act, which made it possible to organize broad-based industrial unions and forced employers to bargain in good faith.

Part of FDR's rationale in passing these laws came straight out of Keynesian economics: One cure for economic depression was putting more disposable income in the pockets of American workers. But FDR also understood that capitalism in a democracy required the consent of the people, and that by giving workers a larger share of the economic pie, his reforms would undercut the potential appeal of government-managed, command-and-control systems—whether fascist, socialist, or communist—that were gaining support all across Europe. As he would explain in 1944, "People who are hungry, people who are out of a job are the stuff of which dictatorships are made."

For a while this seemed to be where the story would end—with FDR saving capitalism from itself through an activist federal government that invests in its people and infrastructure, regulates the marketplace, and protects labor from chronic deprivation. And in fact, for the next twenty-five years, through Republican and Democratic administrations, this model of the American welfare state enjoyed a broad consensus. There were those on the right who complained of creeping socialism, and those on the left who believed FDR had not gone far enough. But the enormous growth of America's mass production economy, and the enormous gap in productive capacity between the United States and the war-torn economies of Europe and Asia, muted most ideological battles. Without any serious rivals, U.S. companies could routinely pass on higher labor and regulatory costs to their customers. Full employment allowed unionized factory workers to move

into the middle class, support a family on a single income, and enjoy the stability of health and retirement security. And in such an environment of steady corporate profits and rising wages, policy makers found only modest political resistance to higher taxes and more regulation to tackle pressing social problems—hence the creation of the Great Society programs, including Medicare, Medicaid, and welfare, under Johnson; and the creation of the Environmental Protection Agency and Occupational Safety and Health Administration under Nixon.

There was only one problem with this liberal triumph—capitalism would not stand still. By the seventies, U.S. productivity growth, the engine of the postwar economy, began to lag. The increased assertiveness of OPEC allowed foreign oil producers to lop off a much bigger share of the global economy, exposing America's vulnerability to disruptions in energy supplies. U.S. companies began to experience competition from low-cost producers in Asia, and by the eighties a flood of cheap imports—in textiles, shoes, electronics, and even automobiles—had started grabbing big chunks of the domestic market. Meanwhile, U.S.-based multinational corporations began locating some of their production facilities overseas—partly to access these foreign markets, but also to take advantage of cheap labor.

In this more competitive global environment, the old corporate formula of steady profits and stodgy management no longer worked. With less ability to pass on higher costs or shoddy products to consumers, corporate profits and market share shrank, and corporate shareholders began demanding more value. Some corporations found ways to improve productivity through innovation and

automation. Others relied primarily on brutal layoffs, resistance to unionization, and a further shift of production overseas. Those corporate managers who didn't adapt were vulnerable to corporate raiders and leveraged buyout artists, who would make the changes for them, without any regard for the employees whose lives might be upended or the communities that might be torn apart. One way or another, American companies became leaner and meaner—with old-line manufacturing workers and towns like Galesburg bearing the brunt of this transformation.

It wasn't just the private sector that had to adapt to this new environment. As Ronald Reagan's election made clear, the people wanted the government to change as well.

In his rhetoric, Reagan tended to exaggerate the degree to which the welfare state had grown over the previous twenty-five years. At its peak, the federal budget as a total share of the U.S. economy remained far below the comparable figures in Western Europe, even when you factored in the enormous U.S. defense budget. Still, the conservative revolution that Reagan helped usher in gained traction because Reagan's central insight—that the liberal welfare state had grown complacent and overly bureaucratic, with Democratic policy makers more obsessed with slicing the economic pie than with growing the pie—contained a good deal of truth. Just as too many corporate managers, shielded from competition, had stopped delivering value, too many government bureaucracies had stopped asking whether their shareholders (the American taxpayer) and their consumers (the users of government services) were getting their money's worth.

Not every government program worked the way it was advertised. Some functions could be better carried out by