Making America Great Again

The Case for the Mixed Economy

Jacob S. Hacker and Paul Pierson

At a debate among the Republican presidential candidates in March, U.S. Senator Ted Cruz of Texas boiled down his campaign message to its essentials: "Here's my philosophy. The less government, the more freedom. The fewer bureaucrats, the more prosperity. And there are bureaucrats in Washington right now who are killing jobs and I'll tell you, I know who they are. I will find them and I will fire them."

What was remarkable about this statement was how unremarkable it was. Cruz was not taking a radical position; he was expressing his party's orthodoxy, using boilerplate language to signal that he understood the conservative movement's core concerns. For years, his fellow Republicans have taken comparable stands. When Texas Governor Rick Perry got into trouble while making a similar pledge in a presidential candidate debate in 2011, for example, it was not because he promised to eliminate several federal agencies—Cruz wants to eliminate even more—but because he couldn't remember all the particular agencies he wanted to jettison.

Even if the candidates making them are elected, specific promises about, say, closing major government agencies are bound to be broken, for reasons of simple practicality. As a debate moderator had pointed out to Cruz a few weeks earlier, for example, once he had eliminated

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the Internal Revenue Service, there would be nobody left to see that taxes were collected, which would pose something of a problem for the functioning of the government. But the spread of this sort of thinking in recent decades has had important effects nonetheless, contributing to increased hostility to government and a major retrenchment in government activities.

Many conservatives complain that this contraction has been too limited and that cutting back even further would unleash powerful forces in the U.S. economy and society that would help solve problems such as slow growth, stagnating incomes, low labor-force participation, and rising inequality. They tell a story about a bygone era of economic dynamism when men and markets were free—a laissez-faire Eden that was lost when progressive politicians such as Woodrow Wilson started using government power to try to "improve" things and ushered in a century of increasingly tyrannical government meddling that has led to a host of terrible outcomes.

The truth is almost precisely the opposite. The spread of capitalism in the eighteenth and nineteenth centuries triggered innovation, growth, and economic progress, but so long as markets were relatively unconstrained, the scale and benefits of that economic dynamism were often limited, inconsistently delivered, unequally distributed, and too frequently unfairly captured by powerful private actors. It was the emergence in the first half of the twentieth century of a robust U.S. government willing and able to act boldly on behalf of the country as a whole that led to spectacular advances in national well-being over many decades—and it has been the withering of government capabilities, ambitions, and independence in the last generation or two that has been a major cause of the drying up of the good times.

There has been nothing inevitable about the trend toward weaker, less functional government; it has been driven by a relentless campaign over many decades to delegitimize the stronger U.S. government that did so much good earlier in the century. So the trend can be reversed. But it will take an equally persistent campaign in the opposite direction, devoted to reminding Americans of what they once understood so well: that a government capable of rising above narrow private interests and supporting broader public concerns is part of the solution, not the problem.

WHAT ADAM SMITH UNDERSTOOD

Like other advanced democratic nations, the United States has what economists call a "mixed economy." In this public-private arrangement, markets play the dominant role in producing and allocating goods and innovating to meet consumer demand. Visionaries such as Apple's Steve Jobs see untapped opportunities to make money by satisfying human wants and then draw on the knowledge and technology around them to produce goods and services for which people are willing to pay. Alongside companies such as Apple, however, government plays a dominant or vital role in the many areas where markets fall short. As the economist Mariana Mazzucato has documented, if you look inside that iPhone, you'll find that most of its major components (GPS, lithium-ion batteries, cellular technology, touch-screen and LCD displays, Internet connectivity) rest on research that was publicly funded or even directly carried out by government agencies.

Jobs and his creative team transformed all of this into something uniquely valuable. But they couldn't have done it without the U.S. government's huge investments in technical knowledge—knowledge that all companies can use and thus none has a strong incentive to produce. That knowledge is embodied not just in science and technology but also in a skilled work force that government fosters directly and indirectly: through K–12 schools, loans for higher education, and the provision of social supports that encourage beneficial risk taking. And even if government had played no role in seeding or enabling Apple's products, it would still be responsible for much of the economic and physical infrastructure—from national monetary policy to local roads—on which the California tech giant relies.

Of course, affluent democracies differ in the exact form that this public-private mix takes, and not all mixes are equally effective. Public policies don't always foster prosperity. Those within government can hurt, rather than harness, the market, distributing favors to narrow interest groups or constraining economic dynamism in ways that stifle growth. No less important (though more neglected), they can fail to respond to problems in the market that could and should be addressed by effective public action, hindering growth through omission rather than commission. For all of this, however, no country has risen to broad prosperity without complementing private markets with an extensive array of core functions that rest on public authority—without, that is, a mixed economy.

That markets fall short under certain conditions has been known for centuries. In the eighteenth century, Adam Smith wrote enthusiastically about the "invisible hand" of market allocation. Yet he also identified many cases in which rational actors pursuing their own self-interest produced bad outcomes: underinvestment in education, financial instability, insufficient infrastructure, unchecked monopolies. Economists have been building on these insights ever since to explain when and why markets stumble and how the visible hand of government can make the invisible hand more effective.

The visible hand is needed, for example, to provide collective goods that markets won't, such as education, infrastructure, courts, and basic scientific research; to reduce negative spillover costs that market participants don't bear fully, such as pollution; to encourage positive spillover benefits that such parties don't take fully into account, such as valuable shared knowledge; to regulate the market to protect consumers and investors from corporate predation and from their own myopic behavior; to provide or require insurance against medical and retirement costs; and to soften the business cycle and reduce the risk of financial crises.

Democracy and the market have to work together, but they also need to be partly independent from each other.

The political economist Charles Lindblom once described markets as being like fingers: nimble and dexterous. Governments, with their capacity to exercise authority, are like thumbs: powerful but lacking subtlety and flexibility. The invisible hand is all fingers. The visible hand is all thumbs. One wouldn't want to be all thumbs, of course, but one wouldn't want to be all fingers, either. Thumbs provide countervailing power, constraint, and adjustment to get the best out of those nimble fingers.

To achieve this potential requires not just an appropriate division of labor but also a healthy balance of power. Markets give rise to resourceful economic actors who want government to favor them. Absent measures to blunt their political edge, their demands will drown out the voices of consumers, workers, and concerned citizens.

Today, most of the discussion of the political power of market actors suggests that such "crony capitalism" can be avoided simply by reducing governance to a bare minimum. As Smith clearly recognized, however, the intermingling of markets and politics is inevitable: a private sector completely free of government influence is just as mythical (and undesirable) as a government completely free of private-sector influence. And a government that doesn't act in the face of distorted markets is imposing costs on society as a whole that are just as real as those imposed when a government acts in favor of narrow claimants. Trying to reduce rent seeking by crippling active government means embracing a cure far worse than the original disease.

The mixed economy, in short, solves a major dilemma. The private markets that generally foster prosperity routinely fail, sometimes spectacularly so. At the same time, the government policies that are needed to respond to these failures are perpetually under siege from the very market players that help fuel growth. Democracy and the market have to work together, but they also need to be partly independent from each other, or the thumb will cease to apply effective counter-pressure to the fingers. Smith recognized this dilemma, but it was never resolved adequately during his lifetime, in part because neither markets nor democracies had achieved the scale and sophistication necessary to make broad prosperity possible. In the twentieth century, that changed.

CROSSING THE GREAT DIVIDE

The mixed economy is a social institution, a human solution to human problems. Private capitalism and public coercion each predated modern prosperity. What was new was the marriage of large-scale profit-seeking activity, active democratic governance, and a deepened understanding of how markets work (and when they work poorly).

As in any marriage, the exact terms of the relationship changed over time. In an evolving world, social institutions need to adapt if they are to continue to serve their basic functions. Money, for example, is still doing what it has always done: providing a common metric, storing value, and facilitating exchange. But it's now paper or plastic rather than metal and more likely to pass from computer to computer than hand to hand. Similarly, the mixed economy is defined not by the specific forms it has taken but by the specific functions it has served: overcoming market failures and translating economic growth into broad advances in human well-being.

The effective performance of these functions has delivered truly miraculous breakthroughs. Indeed, the mixed economy may well be the greatest invention in history. It is also a strikingly recent invention. Plot the growth of Western economies on an axis against the passage of time, and the line would be mostly flat for thousands of years. Even the emergence of capitalism, momentous as it was, was not synonymous with the birth of mass prosperity. Trapped in a Malthusian race between population and sustenance, societies remained on the brink of destitution until well into the nineteenth century. Life expectancy rose only modestly between the Neolithic Period, about 10,000 BC to 3500 BC, and the Victorian era, 1837 to 1901. An American born in the late nineteenth century had an average life expectancy of around 45 years, and a large share of Americans never made it past their first birthdays.

Then something remarkable happened. In countries on the frontier of economic development, human health began to improve rapidly, educational levels shot up, and standards of living began to grow and grow. Within a century, life expectancies had increased by two-thirds, average years of schooling had gone from single to double digits, and the productivity of workers and the pay they took home had doubled and doubled and then doubled again. With the United States leading the way, the rich world crossed a great divide—a divide separating centuries of slow growth, poor health, and anemic technical progress from one of hitherto undreamed-of material comfort and seemingly limitless economic potential. For the first time, rich countries experienced economic development that was both broad and deep, reaching all major segments of society and producing not just greater material comfort but also fundamental transformations in the health and life chances of those it touched.

The mixed economy lay at the heart of this success, in the United States no less than in other Western nations. Capitalism played an essential role, but it was not the new entrant on the economic stage; effective governance was. Public health measures made cities engines of innovation rather than incubators of illness. The meteoric expansion of public education increased not only individual opportunity but also the economic potential of entire societies. Investments in science, higher education, and defense spearheaded breakthroughs in medicine, transportation, and technology. Overarching rules and institutions tamed unstable financial markets and turned boom-bust cycles into more manageable ups and downs. Protections against excessive insecurity and abject destitution encouraged the forward-looking investments and social integration that sustained growth required. The mixed economy was a spectacularly positive-sum bargain: it redistributed power and resources, but as its impacts broadened, virtually everyone was made massively better off.

In nations where the mixed economy took hold, the economy underwent spectacular growth. Not coincidentally, government did too. Indeed, it grew even more quickly. At the end of the nineteenth century, government spending (at all levels) accounted for around one in ten dollars of output in the wealthiest nations. By the end of the twentieth, it averaged over four in ten dollars, with the public sector accounting for six in ten dollars of GDP in the highest-spending rich nations. In some ways, these numbers overstate government's size, since much of government spending essentially shifts private income from one person or household to another rather than financing goods or services directly. Yet standard measures also understate the size of government, because they don't include many of the ways that government affects the economy: from regulation to protections against risk to the provision of legal safeguards. Suffice it to say that for all their imperfections and ambiguities, the numbers capture something real: government has grown much bigger.

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Before looking at statistics such as these, one might assume that poor countries have large governments—at least compared with the size of their puny economies—and rich countries, small governments. After all, there are a couple of big tasks that governments have to do just to remain governments: provide at least a modicum of protection against internal violence and protect against external threats. These are pretty much fixed costs, or at least costs that vary with country and population size far more than economic heft, so one might expect that as the economy grows, the relative size of the state shrinks.

But that is not at all what happened. The richest countries expanded their governments the most. They upped their public spending dramatically during the period in which they grew most quickly, issued more regulations, expanded their legal systems, and offered implicit and explicit guarantees to private actors that were costless on paper but almost incalculably valuable in practice (such as serving as lenders of last resort). Modern growth occurred where, and only where, activist government emerged. And therein lies a big clue as to why the great divide was crossed.

Perhaps the most important thing that big states started doing was educating their citizens. Modern growth commenced when people rapidly increased their ability to do more with less. They were able to do more because they knew more, and they knew more, in part, because they were taught more. The beneficial forms of what the economist Robert Solow famously called "technical change"—the ideas and innovations that allow people to be more productive—rest on widespread public education that seeds scientific advances and equips workers with new skills. Indeed, economists have concluded that roughly a third of rising productivity is tied directly to increased education, with most of the rest due to general advances in knowledge.

Government has unique capacities that allow it to solve problems that markets can't solve on their own.

Government was no less crucial to another pillar of modern prosperity, the physical infrastructure that helped make the scientific infrastructure possible and productive. Even before rich countries came to depend on public investments in science and technology for rapid growth, they depended on public investments in transportation and communications networks that linked together producers and their suppliers and consumers. Among other benefits, public infrastructure facilitated the rapid flow of materials and people across long distances, allowed manufacturers to benefit from economies of scale that supported modern assembly-line techniques, permitted innovations to diffuse and goods to reach far-flung consumers, and created opportunities for workers to find jobs that matched their skills.

THE LOGIC OF GOVERNMENT INTERVENTION

Why does it take a lot of government to get and keep prosperity? Because government has unique capacities—to enforce compliance, constrain or encourage action, and protect citizens from private predation—that allow it to solve problems that markets can't solve on their own. These problems are both economic and political; they concern areas in which markets tend to fall short and areas where market actors tend to distort democratic processes in pursuit of private advantage. And even beyond correcting market failures, government can play an important role in helping markets do better at serving human needs.

One important market failure comes in the underprovision of what economists call "public goods," valuable things that must be provided to everyone or no one. The classic example is a lighthouse. Its light is available to all ships navigating a coastline. There is no cost-effective way to limit the lighthouse's benefits to paying customers, so nobody has a reason to pay. And if no one pays, markets won't motivate anyone to provide the good. Public goods of this kind are prevalent in modern life. The biggest, most obvious example is national security, which consumes one-sixth of U.S. federal spending, but the same logic applies to infrastructure and fundamental scientific research, the latter of which is the cornerstone for technological innovation.

Another kind of market failure involves the effects of market operations on people who are neither buyers nor sellers. Economists call these effects "externalities," and a classic example of a negative externality is pollution. In an unregulated market, neither a factory owner nor a firm's customers have strong incentives to care about what happens to, say, the noxious byproducts of the factory's manufacturing processes. So in an unregulated market, the factory can spew toxins into the air or water with impunity. Where such externalities are present, the market prices for the goods in question will not reflect the true social costs (or, for positive externalities, the benefits) of the private transaction.

Externalities are always an issue, but they become a much bigger issue as economies develop. In dense, complex modern societies, externalities are ubiquitous, and the associated costs (or untapped benefits) of bad market signals, potentially momentous. They include the dangers to the financial system of excessive risk taking among bankers, the dangers to public health if children are not inoculated against disease or are exposed to brain-damaging levels of lead, and the forgone human potential (and squandered economic production) if children are not given a quality education. Even the spiral of underconsumption that follows a downturn can be seen as an externality: everyone retreating from consumer markets at once means more lost jobs and an economy that continues to underperform. What's individually rational is collectively destructive, and hence governments may need to step in to reverse the slide with countercyclical policies.

In complex societies, failures caused by incomplete or asymmetrically distributed information (when one party to a transaction knows a lot more than another) also become more ubiquitous. Insurance markets routinely fall short, for example, when buyers know more about the risks they face than do sellers (who then figure out many ways to exclude or limit coverage for those they fear will be costly). This is one reason why publicly provided or subsidized insurance has proved a mainstay of all rich countries, protecting people against risks they cannot protect themselves against and encouraging investments that entail such risk (such as investment in human capital that might lose value in a dynamic economy where needed skills change rapidly).

And it's not just that information can be incomplete or unevenly distributed. Although even broaching the subject invites charges of paternalism, the fact is that people can be very bad at making very important decisions when those decisions are complex, confusing, or involve long-term costs and benefits. As behavioral economics has increasingly shown, myopia and the difficulty of delaying gratification are important reasons for such negative outcomes as insufficient retirement savings and premature death due to smoking. In this context, government "nudges" or even more vigorous pushes—when informed by science and designed to preserve individual autonomy—can be enormously prosperity enhancing.

Because governments have chosen to intervene to provide public goods, counter negative externalities, and do some benign nudging, hundreds of millions of lives are now healthier, safer, and better protected against financial risk. In the United States and other rich democracies, the majority of government spending goes to social programs related to health care (Medicare and Medicaid) and retirement (Social Security), and the majority of regulation involves protection of the public from the operations of unscrupulous private actors. These programs are overwhelmingly popular even though they are also, as a rule, coercive. That is not a paradox; it's the point—because government is doing things that people need to get done but can't or won't do themselves.

FROM THE FOUNDERS TO THE PROGRESSIVES

The emergence of modern economies capable of generating unprecedented affluence has coincided with the emergence of activist government capable of extensive taxation, spending, regulation, and macroeconomic management. The United States' emergence as a world economic power in the latter half of the nineteenth century featured plenty of enterprising citizens seizing on the opportunities for economic advancement that the U.S. Constitution protected. But the role of the founders and their political heirs was much more direct. They built a state with the power to tax, spend, enforce, defend, and expand. Once in office, they often used the shrewd deployment of vast public lands as a substitute for taxation but with similar effects. They and their colleagues helped create a continental nation linked by infrastructure, governed by a federal legal system, and boasting the most educated work force in the world.

This trajectory was a reflection of the Constitution's purpose and design, not (as many charge today) a betrayal of them. The leading statesmen who gathered in Philadelphia in 1787 were keenly aware of the need for effective government authority. Indeed, they had become convinced that its absence was a mortal threat to the fledgling nation. Perhaps the most influential of them all, James Madison, put the point bluntly at the Virginia ratifying convention: "There never was a government without force. What is the meaning of government? An institution to make people do their duty. A government leaving it to a man to do his duty, or not, as he pleases, would be a new species of government, or rather no government at all." In designing a substitute for the loose Articles of Confederation, which had brought so much instability and vulnerability, the authors of the Constitution also put in place most of the basic instruments of governance that would become the seeds of the United States' economic flowering.

As the country reached its centenary, however, the sapling that had grown faced stiff new winds from concentrated corporate power. What came to be known as the Gilded Age is now sometimes portrayed as a glorious time of unchecked individual initiative to which the country should aspire to return. The lesson it actually teaches is very different: that a modern industrial economy cannot function without independent national authority. The business titans of the late nineteenth and early twentieth centuries were skillful in ways both laudable and despicable, but as the economist J. Bradford DeLong has argued, they were also just plain lucky. They came along when national markets were finally possible, they benefited from public land grants and loan guarantees, they capitalized on economies of scale that allowed early movers to bury rivals, and they then monetized future profits (likely or imagined) through volatile and manipulable financial markets.

The monopolistic capitalism that emerged during this era was unsustainable—economically, politically, and, although few paid attention to it at the time, ecologically. Prior government policies had been successful in promoting development. Without them, building the railroads likely would have taken decades longer, with a huge economic loss. But these policies fostered concentrated corporate power that the federal government lacked the capacity to govern effectively, and the costs to American society of that incapacity were skyrocketing. Workplace accidents soared as industrial and rail work expanded. The toxic financial assets of the era caused repeated economic crises. The social and environmental costs of industrialization were devastating. Weak and penetrated by private interests, courts provided little recourse, whether to victims of fraud, monopolies, accidents, or tainted food or medicine. And so long as government sat on the sidelines, the harms just kept multiplying. It was only a matter of time before a reaction set in, and eventually it did, in the form of the Progressive movement.

The Progressives set out to rescue capitalism, not replace it.

Theodore and Franklin Roosevelt, two of the movement's most prominent figures, were distant cousins and very different men. But they shared a conviction that government had to be strengthened to rebalance American democracy and ensure broadly distributed gains. Either could have said what Teddy declared in 1910: "The citizens of the United States must effectively control the mighty commercial forces which they have called into being."

Theodore Roosevelt would not live to see that goal achieved during his lifetime. The list of major reforms enacted in the first two decades of the twentieth century, under Roosevelt and Wilson, is long: the enfranchisement of women, the direct election of senators, the nation's first income tax, workers' compensation, the Clayton Antitrust Act, the establishment of the Federal Reserve, the first restrictions on money in politics, the first serious attempts at environmental preservation, and extensive new national regulations, including the Pure Food and Drug Act of 1906, which laid the foundation for the U.S. Food and Drug Administration. Yet Roosevelt died in 1919, on the eve of another decade of financial speculation and runaway inequality, during which public authority decayed while problems festered—until, of course, an economic crisis made continued inaction untenable once again.

Picking up where Theodore Roosevelt and Wilson had left off, Franklin Roosevelt put in place a broad range of policies that inserted government deeply into previously untouched areas of the U.S. political economy. The New Deal brought tougher financial oversight, including the creation of the Securities and Exchange Commission. With the National Labor Relations Act, it brought organized labor into the mixed economy's emerging system of countervailing power. With the Social Security Act, it introduced a widely popular system of social insurance that would protect the American middle class from some of the risks associated with modern capitalism. And with the emerging national system of taxes and spending, the New Deal added to the growing tool kit of macroeconomic management that would prevent or moderate future economic downturns.

Despite the interregnum of the 1920s, therefore, it makes sense to think of the two Roosevelts as bookending a long Progressive era. It was progressive because at crucial moments, nearly everyone in a position of high public leadership came to believe that the U.S. social contract needed updating. It was long because challenging entrenched elites proved difficult, and only persistent agitation and huge disruptions to the U.S. political order allowed the translation of these new beliefs into new governing arrangements.

THE HEYDAY OF THE MIXED ECONOMY

The Progressives set out to rescue capitalism, not replace it. The academic who oversaw the development of the Social Security Act, Edwin Witte, said of it, "Only to a very minor degree [did the act] modify the distribution of wealth, and it does not alter at all the fundamentals of our capitalistic and individualistic economy." The welfare state softened the sharp edges of capitalism without tight restrictions on economic dynamism. At the core of the new system that emerged was an exchange: the government would take much larger amounts of money from citizens than ever before, and then it would turn around and spend that money on various projects that benefited those same citizens, both individually and collectively.

Before the twentieth century, income taxes had barely existed in the United States, and before World War II, they had brought in no more than two percent of national income. By 1943, they raked in 11 percent, and the share of the population paying them skyrocketed from seven percent to 64 percent.

At first, most of the money went to the war effort, of course. But research in universities and industrial labs also benefited. And as scientists flocked to U.S. universities to join in the action, young Americans poured into college with funding from the GI Bill. Rivaling these investments in research and education, both in scale and in social return, were vast government outlays for highways, airports, waterways, and other forms of infrastructure. The interstate highway system began with Dwight Eisenhower's 1956 National Interstate and Defense Highways Act, which dedicated over $200 billion (in current dollars) to the cause and hiked the nationwide gas tax to provide highway financing.

New Deal programs devoted to economic security expanded as well. With Eisenhower's strong support, Congress extended Social Security to cover almost all Americans and made it generous enough to pull more of the elderly out of poverty, even as disability protections were added. National health insurance—proposed by President Harry Truman but opposed by the growing private health industry—never made it to the floor of Congress, but wartime wage and price controls that permitted supplemental benefits, the spread of collective bargaining, and tax breaks for health insurance helped push private coverage up to an eventual peak of around three-quarters of Americans by the mid-1970s. The federal government also subsidized and regulated private pensions that built on top of Social Security.

As these tax breaks suggest, the new U.S. state was no unchecked Leviathan. It commingled public and private spending, direct outlays and indirect subsidies, central direction and decentralized implementation. It fostered pluralistic competition for funds among researchers, contractors, and private intermediaries, as well as among states and localities. But it was enormously active and enormously successful—and soon its rewards would extend to groups that had yet to feel the warm sun of American prosperity.

In expanding rights for women and minorities—through statutes, judicial action, and the government's own example (most profoundly, in the armed services)—the nation was finding money on the table. Government policies also boosted the skills and opportunities of the least advantaged, where the returns on such investments were highest. As the federal government expanded, it did not merely extend opportunities to individuals on the periphery of prosperity. It also extended opportunities to places on the periphery, especially the South, injecting assistance and employment, housing and highways, development projects and defense jobs into regions previously left behind by modern economic growth.

As the postwar period wore on, U.S. leaders made another vital contribution to the country's rising prosperity, pushing to address market failures associated with an increasingly dense, interconnected, and complex commercial society. The most obvious breakthroughs concerned pollution, which rapidly came to be seen as a fundamental threat to quality of life requiring vigorous regulation. The federal government also improved protections for worker safety, and in response to the growing profile of activists such as Ralph Nader, it paid much more attention to vulnerable consumers in areas as diverse as tobacco and automobiles, using the power of the state to protect citizens from the predation of others and to limit the potential damage from their own myopic choices (such as smoking cigarettes or failing to wear a seat belt).

The story of the United States' rise to richness is a story of an ongoing rebalancing of political institutions and economic realities, of public policies, social knowledge, and democratic demands. But the arc of that history bends toward a more extensive role for government, and for good reason: As the United States changed from an agricultural society into an industrial society and then a postindustrial society, the scale of economic activity and the interdependence and complexity of that activity grew, and so did the resulting damage. As the nation's leaders responded to these challenges and to pressures for action and inclusion from below, they came to recognize that making Americans healthier, better educated, and freer to pursue their own dreams—regardless of race, gender, and ethnicity, whatever the circumstances of their birth—made America richer, too.

THE BEGINNING OF THE BACKLASH

For roughly 30 years, from the early 1940s to the mid-1970s, the mixed economy of U.S. capitalism achieved unprecedented success, nurturing innovation, sustaining stability, and generating opportunity and prosperity. This successful model rested on a series of social and political understandings, compromises, and accommodations. Given their power in U.S. society, leading business figures were necessarily key participants in this success. Prominent Republicans became believers as well.

The most famous GOP convert was the general turned politician Eisenhower. He understood that the Republican Party needed to make its peace with most of the policy achievements of the previous two decades. In 1954, for example, Eisenhower privately ridiculed the desire of conservatives to roll back the New Deal: "Should any political party attempt to abolish social security, unemployment insurance, and eliminate labor laws and farm programs, you would not hear of that party again in our political history. There is a tiny splinter group, of course, that believes you can do these things. . . . Their number is negligible and they are stupid." Eisenhower's point was that the mixed economy was an established reality and there was no going back.

Eisenhower's domestic policy agenda focused on economic growth, and Democrats would criticize him for his reluctance to rely on Keynesian policy to prime the economy. Yet his administration devoted substantial energy to policies designed to improve the country's long-term economic performance. And on economic issues, the moderate consensus continued after Eisenhower left office. Although John F. Kennedy famously adopted a more Keynesian stance on the budget (built around business-friendly tax cuts), in most respects his economic policies followed the tracks laid down in the 1950s. When the GOP veered right with Barry Goldwater's candidacy, and Lyndon Johnson tacked left with the inclusionary policies of the Civil Rights Act and the War on Poverty, much of the business establishment went with Johnson.

Richard Nixon was one of the last Republican leaders to embrace the mixed economy, and embrace it he did. Nixon's efforts to fashion a new majority involved positioning himself to the right of Democrats on issues of race and crime, but he was willing to be a moderate, even an activist, on matters related to the economy. He supported major extensions of the regulatory state, including big new initiatives for environmental and consumer protection. He favored a guaranteed annual income, a huge expansion of Social Security, and health-care reforms way to the left of what Bill Clinton or Barack Obama ever proposed.

Nixon's moderation was driven in part by political calculations. Encouraged by Daniel Patrick Moynihan, one of his leading advisers on domestic policy, he took the nineteenth-century British prime minister Benjamin Disraeli's "liberal Tory" stance as a model and sought to appeal to working-class and middle-class whites with his support for social insurance and his cautious backing of many of the new regulatory measures coming out of a Democratic Congress. But it wasn't all politics. Nixon accepted the notion that in a large and complex society, government had a fundamental role to play in fostering economic growth and social prosperity. This went beyond the macroeconomic management of boom-and-bust cycles and incorporated support for collective bargaining, extensive social insurance and a reasonable social safety net, the provision of crucial public goods, and interventions to tackle thorny market failures.

As the 1970s continued, however, the mixed economy came under concerted attack by a more powerful and more radical economic elite. At first, the economic and ideological components of this challenge were largely independent of each other. But over time they fused, as the increasing dominance of market-fundamentalist thinking on the right encouraged shifts in corporate behavior and public policy that exacerbated the intellectual and economic distinctiveness of the United States' new economic elite: the deregulation of finance, the slashing of top federal tax rates, growing links between the financial and the corporate sectors, an upward spiral of executive pay. An industry of enablers sprang up, with journalists and think tanks and professional associations and lobbyists all helping push the new line, and eventually the movement captured its biggest prize, the Republican Party.

Once the door opened to the new antigovernment stance, policy and profit seeking reinforced each other.

Ideas were crucial, especially in the initial right turn. Within conservative political and intellectual circles and in corporate boardrooms, elements of the fringe libertarian views of the novelist and philosopher Ayn Rand gained prominence. Randian thinking came in both soft and hard forms (an obsession with deficits, say, versus die-hard opposition to taxes and government spending), but in both forms, it had important implications for U.S. understandings of shared prosperity. The valorization of shareholders (even if it was often a cover for the acquisitive aims of top executives or investors planning hostile takeovers) challenged the notion that wealth was a social creation that rested on the efforts of multiple stakeholders, including labor and government. Instead, it implied that prosperity was generated solely by entrepreneurs and investors, thanks to their creativity and daring. In its radical manifestation, it even became something of a conspiracy theory, dividing the world into a persecuted minority that heroically generates prosperity and a freeloading majority that uses government to steal from this small, creative elite.

These ideas began to gain credence with the emergence of "stagflation," a stubborn combination of high inflation and economic stagnation that plagued the country in the second half of the 1970s and seemed to rebut the notion that government could manage the economy effectively. But what occurred was not simply an ideological shift; opposition to the mixed economy took off because it intersected with and guided powerful economic interests that were themselves gaining political influence. Facing meager profits and depressed stock prices, business leaders mobilized to lobby Washington as never before. They accepted the diagnosis offered by the new market fundamentalists that the source of their woes was not foreign competition or deindustrialization or hostile financial players but rather unions and government intervention in the economy.

The conservative elite's turn against the mixed economy just kept going and going.

Once the door opened to the new antigovernment stance, policy and profit seeking reinforced each other. The free-market movement advocated financial deregulation and tax cuts, and these policies helped fuel a rapid and sweeping shift in corporate America. Companies faced intense pressure to become better integrated into an expanding global economy. Even more important, they faced intense pressure to become better integrated into an expanding financial sector. As corporate America orbited ever closer to Wall Street, it adopted Wall Street's priorities as its own: immediate stock returns, corporate financial engineering, and extremely high executive pay closely tied to share prices. Meanwhile, the constraint on top management created by organized labor was rapidly weakening, as unions struggled in an increasingly hostile climate.

The result was not just enormous fortunes going to a narrower and narrower slice of executives. It was also an enormous shift in power toward a new corporate elite that was much more hostile to the mixed economy, much less constrained by moderates in government or by organized labor, and much more in tune with the new celebration of the market.

In retrospect, the economic tumult of the 1970s looks less baffling than it did at the time. The surge of inflation reflected both singular shocks (notably, the 1973–74 OPEC oil embargo) and obvious policy mistakes (Johnson's guns-and-butter spending and Nixon's urging of loose monetary policy to secure his reelection). Productivity growth slowed as the burst of economic activity after World War II gave way to the more normal expansion of rich countries at the edge of the technological frontier. And the United States faced greater competition from its affluent trading partners as they recovered from wartime devastation.

But inflation captured the public's attention and drove the increasingly panicked national debate, eventually leading Jimmy Carter to appoint the prominent inflation hawk Paul Volcker to head the Federal Reserve. As expected, he raised interest rates sharply, triggering the worst economic downturn since the 1930s. Not only did the recession probably cost Carter the 1980 election; it battered the economic reputation of the Democratic Party. The episode paved the way for Ronald Reagan to pursue a very different vision of government's relationship to the economy.

But however sobering the economic challenges of the 1970s might have been, they did not need to tarnish the entire edifice of the mixed economy. Getting macroeconomic policy on a sounder track and confronting heightened foreign competition did not require unwinding government's constructive role in ensuring broad prosperity. The social institution of the mixed economy could have been updated; the balance between effective public authority and dynamic private markets could have been recalibrated rather than rejected. Nor did popular pressures demand radical change. Voters may have turned right as inflation increased, but the conservative shift in public opinion was short lived. It was the conservative elite's turn against the mixed economy that just kept going and going, even intensifying over time, and it was that which ended up bankrolling and driving the ideological warfare that ensued.

BACK TO THE FUTURE

When Eisenhower delivered his first State of the Union address, he drew on a broad reservoir of support for the mixed economy. He took for granted that government made fundamental contributions to shared prosperity. Those within his party who thought otherwise were marginalized. Business leaders, too, recognized that they had to engage with government and labor as partners. Many genuinely accepted the partnership, but all understood that they had to accommodate it.

Forty years later, when Clinton took the podium to deliver his inaugural address, the world looked different. The reservoir of enthusiasm for government was dry, baked away by the relentless attacks on government that politicians of both parties had found were the surest way to gain national office. Declining public trust eroded support for active government and created a political vacuum that powerful private interests filled. A revitalized Republican Party led the assault. Yet even the party of government—and those, such as Clinton, who led it—found the spiral of anti-Washington sentiment hard to escape, especially as those powerful private interests became increasingly central sources of financial support.

The corporate world had changed as well. The financial restructuring that had begun in the 1980s had reshaped the character, leadership, and culture of American business. Among those favored by these changes, older understandings of what produced prosperity had given way to new conceptions of the relationship between business and government, the process of wealth creation, and the contribution of managers versus workers—conceptions sharply at odds with those supporting the mixed economy. In the new corporate world, business leaders who praised the active role of government or were willing to engage with political leaders to pursue broad prosperity were harder to find.

In this new climate, the excesses and inadequacies of government loomed larger than its benefits. Some of this frustration was, and continues to be, entirely legitimate. American government has indeed become less effective. The lawmaking process has become dysfunctional. Public policy is more beholden to narrow and deep-pocketed interests. Political attacks and pervasive public distrust make government less capable, which in turn provides fodder for more attacks and greater distrust. That this vicious cycle has been pushed along by smear attacks and sabotage campaigns does not make it any less real.

But just because government often performs tasks less well than it could or should doesn't mean that we would be better off without it, or even with less of it. The net benefits of modern government are enormous—at the level of major programs and, even more clearly, at the level of governance as a whole.

The mixed economy remains a spectacular achievement. Over the past century, the United States and other advanced democratic countries leapt across the Great Divide. They broke from the entirety of prior human existence, in which life was nasty, brutish, and short for almost everyone, and entered an era in which most citizens could look forward to long lives, a real education, and previously unimaginable material comfort. By combining the power of markets with a strong dose of public authority, they achieved unprecedented affluence.

The good news, moreover, is that these positive-sum achievements don't have to stop coming. Despite today's pessimism, many opportunities to make society better off still beckon, in part because for decades Washington has not been using government to best effect. But the bad news is that for this to happen, the nation's ideological and political climate must begin to shift, and the great American amnesia must finally lift.

Many changes have swept the U.S. economy since the 1970s. Yet the country's biggest problem is not a lack of attractive policy options. The United States' biggest problem is its politics. Roads, bridges, and transportation networks can be rebuilt, scientific research can flourish, and educational funding can be provided from early childhood through college—if only there were a renewed commitment to using activist government on behalf of the public good. The growth of health-care spending could be slowed, pollution could be diminished further, renewable energy could be sped toward feasibility. It is possible for Americans to live in a society that is not just fairer and more contented but richer as well. There may not be a free lunch, but there are lots of cheap, delicious, and highly nutritional lunches just waiting to be eaten, simply by returning to the mixed-economy playbook of a couple of generations ago, with appropriate updating for what has been learned since then.

In many specific areas, of course, Americans still believe that the public sector has a vital role. They support government regulation of the environment and government funding of education. They strongly endorse Social Security, Medicare, and most other social programs. They believe that political leaders have a responsibility to manage the economy. What has changed is that voters have become profoundly skeptical that government has the capacity or inclination to foster broad prosperity, especially when doing so requires it to take on new or newly intensified challenges or confront powerful entrenched interests. To build a mixed economy for the twenty-first century, a critical mass of citizens—and their leaders—has to believe once again that government can address their most pressing concerns.

The framing of "government versus the market" has become so ubiquitous in modern culture that most Americans now take it for granted. The hostility of the right is unceasing and mostly unanswered. Eloquent leaders often defend individual programs but too rarely defend the vital need for effective governance. Politicians facing electoral pressures participate in a spiral of silence. Chastened by government's low standing, they reinforce rather than try to reverse it.

Rhetoric is only one part of the problem. Cowed policymakers also design programs that send much the same message. The political scientist Suzanne Mettler has documented the increasing tendency to "submerge" policies so that the role of government is hidden from those who receive benefits. These subterranean policies include tax breaks for private savings for education and retirement and a reliance on private companies and contractors even when these proxies are less efficient than public provision. These submerged benefits are usually bad policies. More important, they are even worse politics. Voters who don't recognize government in action are not likely to appreciate what government does. Nor are they likely to form an accurate picture of government's role, seeing only its visible redistribution and not the vast number of ways in which it enables prosperity.

To get to that more realistic starting point will require a serious and prolonged investment in ideas. The crisis of public authority is a consequence of orchestrated, persistent efforts to tear down government and a long spiral of silence in response. To shake free of the amnesia about the benefits of a mixed economy and rebalance the national conversation will take many years of leadership and activism. The intellectual and organizational foundations of effective public authority will have to be rebuilt. Reform must be a multifront, interdependent effort in which robust but realistic steps steadily build trust and momentum toward a revitalized mixed economy.

The specific arrangements that enabled the U.S. economic model of the last century are dead and buried. But it is possible to build a new model for economic success, on new political foundations, to deepen prosperity in the twenty-first century. And today's complex and interdependent knowledge economy offers tremendous opportunities for positive-sum bargains that will strengthen both U.S. capitalism and the health of U.S. society. Grasping these opportunities, however, requires a mixed economy—the strong thumb of government as well as the nimble fingers of the market. This is the truth that both history and economic theory confirm: the government that governs best needs to govern quite a bit.